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Politics this week

Jul 5th 2001
From The Economist print edition

Milosevic in the dock

EPA

Facing an international tribunal at The Hague, Yugoslavia's former president, **Slobodan Milosevic**, told the court he did not recognise its authority and refused to plead. The Bosnian Serb prime minister said he would hand over, if he could find them, **Radovan Karadzic** and **Ratko Mladic**, the two men most wanted for war crimes in Bosnia.

See article: In the dock, at last

Under pressure from NATO, the government and the ethnic-Albanian guerrillas in **Macedonia** signed ceasefire agreements.

Under threat of a Russian veto, America and Britain withdrew their attempt to impose smart **sanctions on Iraq**. Their proposal would have eased the import of civilian goods but tightened controls on illicit trade. Instead, the four-year oil-for-food programme was routinely extended. Two senior Iraqi diplomats at the UN were reported to have asked for asylum in the United States.

See article: Smart exit

A visit by Colin Powell, America's secretary of state, failed to shore up the crumbling **Israeli-Palestinian ceasefire**. The Israeli government, asserting the right to assassinate militants, killed five Islamist activists, plus a mistakenly suspected taxi driver. Palestinians killed three Israeli civilians. In all, 15 Palestinians and nine Israelis have been killed since the truce came, supposedly, into effect on June 13th.

See article: No quiet, no peace

A world of trouble

Nigeria was shaken by ethnic and religious fighting, in both Nassarawa state in the centre of the country and Bauchi state, to the north. Hundreds of people were reported killed after Christians rebelled against an attempt to impose Islamic law in the town of Tafawa-Balewa.

See article: Village against village

Activists from Greenpeace, till now an environmentalist organisation, invaded an air-force base in **Britain** in protest at possible plans to use its radars for America's missile-defence scheme. In **Cyprus**, protesters ostensibly worried about cancer, invaded a British military base, in protest at the erection of radio masts.

See article: Matsakis and the mast

AP

Thousands of **Zimbabweans** went on a two-day strike to protest against a huge rise in the price of fuel. The capital, Harare, came to a stop.

For the second time in a month, **Algerian Berber** dissidents attempted a march on the capital, Algiers. The authorities set out to stop them.

In the diamond-mining town of Kono in eastern **Sierra Leone**, about 30 rebels surrendered their weapons to UN monitors.

Russia faced criticism for declining to attend an EU-sponsored meeting of Caspian states in Azerbaijan that introduced measures to counter the decline of the sturgeon. Russia claimed that it had its own plan to husband the caviare-producing fish and pull some species back from the brink of extinction.

AP

In and out of jail

Relations between the **United States and Japan** were strained by a delay in handing over to the Japanese an American airman suspected of raping a Japanese woman in Chatan, Okinawa. This prompted renewed calls for a reduction in the numbers of American troops on the island of Okinawa.

An American **spy plane** that made a forced landing on the Chinese island of Hainan in April was returned to the United States in bits.

Carlos Menem, a former president of **Argentina**, two former ministers and a former chief of the armed forces were charged with conspiracy to ship government guns and explosives illegally to Croatia and Ecuador between 1991 and 1995.

EPA

See article: A worm turns

As part of an agreement with the government, the largest guerrilla group in **Colombia**, the FARC, released 242 police and soldiers who had been held captive for up to three years. This was about 100 more than expected. A humanitarian gesture, said the FARC, as it stepped up its military campaign.

See article: Don't celebrate yet

A retired **Brazilian police colonel** was sentenced to 632 years in prison for ordering the massacre of 111 prisoners in a jail riot in 1992. He was freed pending an appeal.

India said it would free more than 400 **Pakistani prisoners** as a goodwill gesture before its summit meeting with Pakistan starting on July 14th.

The **Falun Gong** cult said that at least 15 of its followers had been tortured to death in a Chinese prison camp in June. Officials denied it.

Coming and going

Two views of immigration in Europe. In **Germany**, an official commission recommended the admission of 50,000 mostly skilled non-EU workers each year, plus their dependants. **Italy**'s new labour minister is considering legislation that would let non-EU citizens stay only as long as they had jobs.

Worries about the health of **Dick Cheney**, the United States' vice-president, persisted. He had a pacemaker fitted to control an irregular heartbeat.

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Business this week

Jul 5th 2001
From The Economist print edition

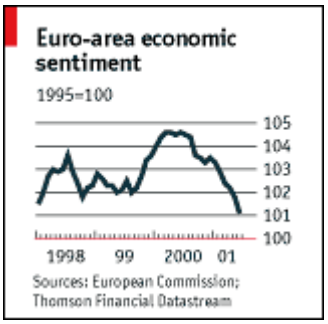
Blocked

The European Union ended the long-running saga of **General Electric**'s attempted takeover of **Honeywell** by blocking the deal. Concessions offered by GE fell short of what the European Commission required. America's regulators had long since approved the deal.

See article: Engine failure

Lukoil, a Russian oil company that does business in Iraq, Iran and Sudan among other places, switched a planned share offering from New York to the London Stock Exchange. The company wishes to avoid possible action against it by America's government for trading with regimes of which the Americans disapprove.

Confidence in the **euro-area economy** fell in June for the sixth month in a row, according to a European Commission survey. Manufacturing also seemed to suffer a steep decline. The euro-area purchasing-managers' index fell steeply, led by a worrying dip in Germany.



Japan's Tankan survey of business confidence plummeted, reflecting deep pessimism about the future of the country's ailing economy. However, in **America**, the National Association of Purchasing Management's index measuring manufacturing activity improved in June. Also, orders for factory goods were up in May, as was consumer spending.

The IMF postponed a meeting meant to authorise the release of further cash for **Turkey**. The government had not made enough progress on promised reforms, the fund said.

Off the runway

Belgium's government threatened to take legal action to force Swissair to take over **Sabena**, a struggling state-controlled airline. **Swissair** owns 49.5% and had promised to increase its stake to 85%. The Swiss airline, deeply involved in several loss-making French airlines, offered some cash to get out of the commitment; Belgium said "not enough".

United Airlines and **US Airways** admitted that they had begun talks aimed at terminating a merger that would have created the world's largest airline. The deal, announced over a year ago when business was booming, has lost much of its shine and would have faced considerable regulatory resistance.

See article: Air travel, air trouble

KLM Royal Dutch Airlines said that profits for the latest quarter would be far below the *euro*100m ($87m) enjoyed a year ago. Passengers and cargo have dwindled alongside the world economy.

Concert's quiet finale

British Telecom and **AT&T** pulled the plug on Concert, a loss-making joint

venture providing bulk telecoms services to big companies. Both companies have business-telecoms divisions which unavoidably came into competition with the lacklustre joint venture.

Shares in **Marconi**, a large British telecoms company, collapsed on July 5th. They had been suspended the previous day while the board discussed a profits warning. The company says profits will fall by half this year and 4,000 jobs will go in addition to the 3,000 cuts announced earlier this year.

Disharmony in Europe

The European Parliament threw out a **European takeover directive** that would have harmonised takeover rules and boosted shareholders' powers. It had been 12 difficult years in the making. It is increasingly unlikely that the 2005 deadline for a common market for financial services in the European Union will be attainable.

See article: Pull up the drawbridge

Italy's government did not object to a hostile bid for **Montedison**, a large power company, from **Fiat** and **Electricité de France** that valued the firm at around *euro*5 billion ($4.2 billion). EDF's recent lone attempt to grab Montedison was thwarted by legislation to limit the French company's voting rights; Italy was reluctant to allow EDF a role in its deregulated power market.

See article: Dust-up in the drawing room

Mediobanca, an investment bank with a once unassailable grip on Italy's financial markets, was rumoured to be considering a merger with **UniCredito**, Italy's second-largest bank. Mediobanca may want to strengthen its hand: Fiat's move on Montedison could signal the beginning of an unravelling of Italy's cosy web of cross-shareholdings and behind-the-scenes wheeler-dealing.

Merger and acquisition activity in Europe in the first half of the year was just half the total of a year ago at $326 billion, according to Thomson Financial Securities Data. Worsening business conditions and uncertainty about regulatory approval were partly to blame.

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The world's airlines

Air travel, air trouble

Jul 5th 2001
From The Economist print edition

Poor profits, striking pilots, congestion, delays...

THE world's airlines are flying into two sorts of turbulence at once. In the first may lie part of the solution to the second. The cause of the first is the global economic slowdown: in May, air travel fell in the United States and Europe for the first time in a decade. Having been borne aloft on the boom years, airlines will be hurt when times get bad. The second problem is a human one. The airlines' global alliances have led their pilots to expect global pay—harmonised at America's generous levels. It will be bad labour relations that delays passengers most in the coming months.

On any given day, more than 4m people around the world take to the air; at any moment a quarter of a million people are in flight. It is a privilege to be able to do it, but often disagreeable. Bad weather, congestion on the runway, hamstrung air-traffic control, computer failures and the late arrival of the incoming flight all turn air travel into a lottery. Strikes and threats of strikes are the scourge of the moment. Striking bus drivers immobilised thousands of Europeans bound for Majorca, Minorca and Ibiza last weekend. America's Independence Day holiday this week, second only to Thanksgiving Day as an occasion for mass migration, risked turning into mayhem as cabin attendants at American Airlines threatened to strike over pay. Only after President George Bush threatened to use his emergency powers to impose a cooling-off period was a deal struck at the last minute.

That is just a breathing space. Most airlines in America (with the exceptions of Southwest and Continental) are incessantly at war with some of their employees; this includes even United Airlines, where the employees own about half the company. It took Mr Bush's threat to intervene in a dispute in March at Northwest Airlines to prompt the parties to settle. Negotiations with American's pilots are tricky; meanwhile, United Airlines faces a strike vote by its ground crews.

Trouble in America spells trouble elsewhere. Global airline alliances are giving pilots even more negotiating muscle (see article), as European and Asian flight crews seek to raise their salaries to American levels. So the contagion of America's lousy labour relations is spreading abroad, latterly to Lufthansa (which had strikes last month), Iberia Airlines in Spain, which is having them every other day, and to Cathay Pacific in Hong Kong, where pilots are starting a go-slow.

The pendulum swings

For airlines and economies, not to mention the benighted passengers, this is bad news. After all, air transport is as vital to most economies as the railway was a century ago. Airline seats are more perishable than strawberries at Wimbledon, and a pilots' strike can shove an airline into bankruptcy in six weeks.

There is thus an urgent need to reform labour negotiations. In the United States, discussions on contracts drag on for years. When deadlock occurs, the mediation process is slow and cumbersome. A federal board intervenes; if it cannot produce a deal, the White House can appoint an emergency board to mediate, while the workers are forced to stay on the job for 60 days. Thereafter the union may strike, but Congress can impose whatever the emergency board decides.

Part of the answer to the labour problem is to improve this antiquated process. One solution would be to embrace a streamlined form of binding arbitration, along the lines of that used increasingly in American

industries such as baseball. This is known in Britain as “pendulum” arbitration, because the mediator is obliged to come down on one side or another, rather than impose a compromise. Such a rule forces both parties into the centre ground to win the arbitrator’s favour. A law that imposed this would be better than the antique Railway Labour Act, under which presidents now intervene.

The world is their oyster

Curbing the right to strike may seem reasonable, given the economic importance of air travel, but it is hardly a durable solution. Airlines in countries outside the United States need to accept that, in global industries, the rate for skills in short supply is likely to be set globally too.

The shortage of supply is an indirect result of the peace dividend: the world’s taxpayers once subsidised the training of pilots for commercial airlines by financing large airforces. When demand for military pilots declined, so did the supply of cut-price labour. Pilots increasingly have to pay the cost of their own training, something that can easily reach $70,000. Small wonder that pilots, clever folk who often have plenty of time between shifts to discuss their grievances, want to squeeze the largest possible return on their investments.

One solution might be for airlines to train more pilots themselves—or to find ways to reduce training requirements. More important, though, is to alter the basis of pilots’ pay. Most pilots today are rewarded not for their skill but for their seniority. That must change. Computers in cockpits now give managers ample information on whether a pilot is good at keeping fuel consumption down, landing gently and so on.

Airlines that want to keep pilots sweet may also have to fall back on an old-fashioned remedy: good management. Curiously, it may be easier to drive change once airline companies are visibly having a tougher time. The recession will help, by cutting the demand for air travel. So will continued deregulation. In the United States, air travel has tripled since airlines were set free in 1978, while the average fare has fallen by nearly half in real terms.

More deregulation—say, the removal of the laws that prevent foreigners from owning airlines in America or from operating internal flights—would bring more benefits. So would privatising airports: today, municipal ownership often allows the big airlines to keep out new competitors. Outside America, governments need to continue their retreat from ownership of flag carriers. They must press on with liberalising air travel. Industries with vibrant competition have a much greater incentive to sort out pay and labour relations than those protected by legal barriers and national ownership. Remember that, as you snooze on the floor of the lounge this summer.

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Africa's Millennium Action Plan

Old ideas, new commitment?

Jul 5th 2001
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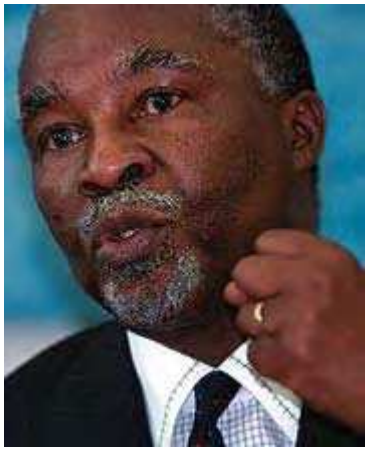
African leaders still have to convince the rest of the world that they are serious

Reuters



THE best thing about the latest plan to develop Africa is that it has no new ideas. The Millennium Action Plan (MAP), which will be presented at the Organisation of African Unity summit next week, offers familiar solutions and entreaties: better government, more democracy, respect for human rights, market reforms and a recognition that globalisation offers advantages (see article). Good. Had the plan contained some smart bomb—a simple solution to Africa's problems that no one had thought of before—it could have been safely ignored.

Instead, it restates all the aims and policies that the world has been urging for years. African leaders now appear to accept that these are not just conditions for aid laid down by western countries but economic reality. That is the new element. In the plan's words, "Africa recognises that it holds the key to its own development." Unlike previous blueprints, this one has been written by Africans. The idea is that, having designed it, they should now commit themselves to implementing it, monitoring it and thus, in the jargon, "owning" it.

The man behind the plan is President Thabo Mbeki of South Africa, who is seeking a way of realising his dream of an "African renaissance". At times the MAP earns its nickname, "Motherhood and Apple Pie", but on the whole it offers common sense: if African governments want foreign capital and overseas markets, they must create investor-friendly political and economic systems. They should concentrate on reducing poverty by providing safe drinking water, better health and more education. They should try to diversify their economies and to process more of their own raw materials. The plan does not ask for huge amounts of new aid, but it does ask that aid should be consistent, co-ordinated and accountable—accountable, that is, to both givers and receivers. Quite reasonably, it asks for trade barriers and agricultural subsidies to be removed by the developed world so that African producers can compete fairly—though many African countries would benefit at least as much if they removed their own barriers as well.

The African leaders at the OAU meeting will be invited to approve the plan and commit themselves to it. The aim is thereby to grab the attention of presidents and prime ministers in rich countries. Tony Blair, Britain's prime minister, is ready to carry the MAP to the G8 summit in Genoa this month.

The rich world should support it, but carefully. History is littered with the corpses of grand schemes to save Africa. The Lagos Plan of Action, for example, was launched with great fanfare in 1980, but nothing came of it. That was not so much because it was flawed as because African governments abandoned their commitments as soon as the going got tough. Most of those commitments had been drawn up by outsiders and accepted by the signatories only in order to win aid. As soon as the aid was received, the promises were forgotten.

What is to stop the same thing happening with the MAP? Nothing at present. The plan provides for monitoring, but there is nothing in the text so far to sanction countries that sign up to it and go off track. Might peer pressure do the trick? Not if Zimbabwe is a guide. Even South Africa, which could exert strong pressure on the errant Zimbabwean president, Robert Mugabe, balks at doing more than tut-tutting. The plan is a welcome sign that Africans are beginning to see the need to put their own house in order. But only clear evidence that they are actually practising honest, accountable government in pursuit of sensible policies will show that they are serious.

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East Asian economies

Falling (again)

Jul 5th 2001
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A new strain of economic contagion is spreading through East Asia

IMAGINE that you had just recovered from a nasty bout of flu. You return to work, promise your doctor that you will give up smoking and join a gym, and then you fall victim to chicken pox. This is how the former East Asian tigers must feel. In 1997-98 they suffered a bruising financial crisis, and now, after only two years of recovery, many of these economies are facing the prospect of yet another slump. This time the recession virus is being spread not by currency speculators, but by the collapse in America's information-technology investment.

East Asia's two biggest export markets are America and Japan. America's economy has slowed sharply over the past year and Japan's is already in recession. As a result, exports and production are tumbling. Real GDP fell in Singapore, Taiwan and Thailand in the first quarter and probably shrank again in the second. Singapore's industrial production fell by 11% in the year to May. South Korea and Hong Kong will be lucky to see GDP growth of 2-3% this year, down from rates of 9% and 10% respectively in 2000. Exports from East Asia, excluding China, have fallen by around 10% over the past year, compared with growth of almost 30% in early 2000. China's GDP growth is holding up, but even its export growth has slowed from almost 40% to 4% over the past year.

Supply-chain dependencies

The smaller East Asian economies are among the world's most open, with exports, on average, accounting for about 50% of GDP. Such openness has spurred their growth for several decades, but it also leaves them vulnerable to a global slump. Worse still they are heavily dependent on the production of IT equipment. Morgan Stanley estimates that as much as two-fifths of Asia's total GDP growth last year came from exports of IT to America. But America's investment boom has now turned to bust: new orders for computers and electronic products fell by a third in the year to May. One reason why the collapse in investment has so far not pushed America into recession is that it has exported some of that recession to Asia.

America's economic boom in the late 1990s, combined with Asia's super-competitive currencies after devaluation, helped the crippled Asian tigers to recover more quickly than expected from their financial crises. However, while exports surged, domestic demand lagged behind. The result is that the Asian economies have become even more dependent upon exports. South Korea's exports of goods and services jumped from 30% of GDP in 1996 to 45% last year; Thailand's rose from 39% to 66%. Asia is therefore more exposed to a world slump than ever before. One reason why China's economy is expected to grow this year by a more robust 8% is that it is less dependent on exports (only 23% of GDP) and much less dependent on IT. In addition, domestic demand looks more robust.

This does not mean that East Asia is heading for another financial crisis. Compared with 1997-98, economies are in much better shape. They now have current-account surpluses instead of huge deficits, and bigger foreign-exchange reserves. With the notable exception of Hong Kong and Malaysia, they have also abandoned the fixed exchange rates that were at the root of their previous meltdown.

During the late 1990s crisis, financial contagion swept through the region as capital fled one economy after another. Today a new strain of contagion is spreading through the global supply chain in IT equipment, as firms in America, Japan and Europe have outsourced their production abroad. East Asia is merely the most extreme case of the increased integration of economies. Global trade volumes grew

twice as fast in the 1990s as the 1980s, so it is hardly surprising that trade now plays a bigger role in the global business cycle. Over the past couple of years America exported its boom, helping East Asia to recover; now it is exporting recession. Growth in the volume of world trade has slowed to around 4% this year from 13% last year—the sharpest deceleration since 1975.

The blame game

Many Asians blame the overseas slump for all their current economic woes. Some will wrongly conclude that further globalisation should therefore be resisted. Actually, in the long run everybody benefits from a globally integrated market when there is diversity of demand and production. But over-dependence on one economy brings drawbacks. Because domestic demand lagged, East Asia's recovery was over-reliant on exports. Asia's large trade surpluses are popularly seen as a sign of renewed economic vigour. In fact they partly reflect a failure to generate stronger domestic demand as a result of not completing promised structural reforms.

As economies bounced back from the crisis faster than expected, governments concluded that reform could wait. Firms have been slow to sell off assets and reduce debts. Banks have been slow to write off bad loans. Governments have failed to deregulate services, which could have created new jobs to offset the collapse in IT exports. Fragile banking systems and inadequate corporate restructuring continue to cramp domestic expansion. Lower interest rates are less effective in stimulating demand because banks saddled with too many bad loans are reluctant to lend more and debt-laden firms cannot borrow.

Governments are now likely to come under pressure to slow trade liberalisation. Instead they need to do the opposite in order to diversify their trade. If the East Asians became more integrated through trade with each other and with China, they would be less dependent on the United States. The smaller Asians tend to view China as a threat, waiting to steal their markets. Yet China could in future become an important engine for regional growth.

Giving up smoking and having regular exercise do not prevent you from catching chicken pox, but healthier people tend to recover faster. Likewise, deeper reforms would not have prevented the global downturn from hurting Asia, but they would have helped to cushion the economy against an export slump. The risk now is that slower growth will cause politicians to shy further away from tough reforms. It is much harder to quit smoking when you feel a little down.

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Microsoft

Guilty

Jul 5th 2001
From The Economist print edition

The appeals court's ruling shows that it was right to sue Microsoft

Get article background

WAS the suit against Microsoft a waste of time, money and effort, that served only to sap the energy of one of America's largest and most innovative firms? Undoubtedly, the decision by the Department of Justice and 19 states to launch an antitrust suit against Microsoft in 1998 was controversial from the start. Critics argued that rules designed to regulate 19th-century smokestack industries could not be applied to the computer business. Microsoft denied that it held a monopoly, and argued that it was simply competing hard in a dynamic, highly innovative industry. Regulators, the company argued, had no right to determine which features software companies should include in their products. When the case came before an appeals court in February, the judges' harsh questioning of the government's lawyers appeared to support the view that the entire case might even be dropped and Microsoft acquitted of any wrongdoing.

It was not. Instead, on June 29th the seven appeals-court judges unanimously ruled that Microsoft holds a monopoly in PC operating-system software, and that it repeatedly and unlawfully used its market dominance to protect that monopoly. True, the court reversed the finding that Microsoft had attempted to monopolise the market for web-browser software, and also overturned last year's ruling by Judge Thomas Penfield Jackson that the company should be split in two. But this good news for Microsoft was outweighed by bad. The court found that its "co-mingling" of other software with Windows was anti-competitive, and it left unresolved the key question of the extent to which Microsoft is allowed to tie, or bundle, other software with Windows, which is crucial to its future plans. In short, a bench of conservative judges deemed that antitrust regulations should be applied even to software.

The most likely outcome now is an out-of-court settlement. This would probably take the form of a fine (painless for Microsoft, which is sitting on $30 billion in cash) and a bundle of conduct remedies, which Microsoft has proved skilful at evading in the past. Unlike a break-up, such a settlement would do little to restrain Microsoft's monopolistic tendencies. But even an ineffectual remedy is better than nothing, and bringing the case has also had other remedial effects.

The next big thing

For a start, the ruling that Microsoft is a monopoly leaves the firm open to a deluge of private suits. Microsoft may now face legal action over the inclusion of media-playback and instant-messaging software in its new Windows XP operating system, which is due to go on sale in October. The ruling may also embolden antitrust regulators in Europe, where the EU's competition commissioner, Mario Monti (see article), has assigned an unusually large team to investigate Microsoft's conduct.

The trial itself had a number of positive consequences. It prompted Microsoft to abandon many of its restrictive licensing agreements with PC makers. As a result, it is now possible to buy PCs with Linux, a free operating system, rather than Windows, installed as standard. Before the trial, this was almost impossible, since PC makers dared not offend Microsoft, which might have cut off their supplies of Windows.

Another result of the trial is that Microsoft is now more widely distrusted. The notion of Microsoft as an evil empire, once an in-joke among geeks, is now a commonplace. The recent fuss over "Smart Tags", a

controversial feature to add web-links to documents automatically that Microsoft was thinking of including in Windows XP, reveals the depth of popular mistrust of the company. That matters: trust is vital if Microsoft is to make .NET, its embryonic Internet platform, a success on the scale of Windows. Access to many of the new features in Windows XP, and to Microsoft's new suite of online services, is available only to users who sign up with Microsoft's online registration system. Users may be reluctant to hand over personal information to a proven bully.

Will the combination of conduct remedies, legal threats, market forces and user mistrust be enough to restrain Microsoft in future? Perhaps, although a break-up was the only remedy that was guaranteed to put a stop to the company's misbehaviour. But, even without a break-up, the appeals court's ruling emphasises that it was undoubtedly right for the Department of Justice and the states to bring the case.

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Slobodan Milosevic

In the dock, at last

Jul 5th 2001
From The Economist print edition

But putting the Serb leader on trial in The Hague is not an unalloyed triumph

WHETHER ringing bells or wringing hands, outsiders grappling with the Balkans have often found in Slobodan Milosevic a man who has his uses. Now that he is safely in The Hague, awaiting trial on charges of crimes against humanity and breaches of the laws of war, he can be presented as an embodiment of the cruelty, hatred and cynical nationalism that have caused so much suffering in former Yugoslavia over the past ten years. His trial will, it is hoped, promote democracy in Serbia and Montenegro, which are all that is left of Yugoslavia, help to bring stability to the rest of the Balkans, and serve as a warning to other despots that torture, murder and ethnic cleansing do not pay. Excellent, if so: his trial certainly deserves to succeed.

For Serbia itself, the republic that Mr Milosevic so brutally and ineffectually sought to aggrandise in four Balkan wars, the trial will, with luck, help to provide a more accurate account of recent history than the Serbia-as-victim version that Serbs still tend to believe. Scales have already been dropping from some Serbs' eyes as news has emerged of mass burials of Kosovars. If the Serbs are to rebuild their country as a democracy, they will not only have to get rid of countless Milosevic-appointed officials still in positions of authority, but they will also have to come to terms more fundamentally with their past. In particular, they will have to recognise that many of their countrymen, however gullibly, were complicit in Mr Milosevic's rule, if only by voting for him in vast numbers in elections.

But it will be understandable if some Serbs also feel that the justice meted out by the Hague court is selective: it is admirable that the court should have got its hands on the top Serb, the man who made policy, and not just those who carried it out, but what of his counterparts among the Croats and even the Bosnian Muslims? And though it is a bit rich for Mr Milosevic to revile the court as "a false tribunal" after he had himself signed an undertaking at Dayton in 1995 to hand over indicted criminals to it, the manner of his own handing over was indubitably distasteful. Surrendered in defiance of Yugoslavia's Constitutional Court, perhaps without the knowledge of its president and certainly to the disgust of its prime minister, Mr Milosevic was, in effect, exchanged for a bounty. The first payments started the next day when western donors offered Yugoslavia $1.28 billion (see article). This may have been a triumph for justice, but hardly for the rule of law.

With no calling to account, there could be no long-term peace in the Balkans. To that extent, Mr Milosevic's trial will be welcome beyond his homeland. It has already prompted the Bosnian Serbs to say they will hand over—if they find them—Radovan Karadzic and Ratko Mladic, the two men most wanted for war crimes in Bosnia. Unfortunately, in Macedonia, the country now closest to the brink of civil war, it is unlikely to make a difference. It would be nice to think that any would-be ethnic warrior, seeing Mr Milosevic's plight, would draw back and try talking instead. But in Macedonia the problem is not so much a headstrong tyrant, leading his people against an oppressed minority, as a weak president, unable to bring his people to their senses and carry out a political negotiation with a provocative, albeit also provoked, minority. In this Balkan corner, Mr Milosevic's example seems unlikely to make matters better, in the short run at least. It would be tragic if anyone should think outsiders could now relax.

Caveat dictator

In the longer run, and in the wider world, the outlook may be more hopeful. Even before Mr Milosevic arrived in The Hague, the arrest in London in 1998 of Augusto Pinochet had raised the possibility that tyrants might be brought to book years after their misdeeds had been committed. That possibility is strengthened by the current effort to set up a world criminal court: 36 of the necessary 60 countries have already ratified the treaty that would bring it into being. Suddenly, the objections to such a court

are being made more vociferously: it might be selective, it might be misused, even “good guys”—peacekeepers, say, who just happened to make a few mistakes—might be mischievously brought to trial.

Fair objections, all of them, up to a point. But if the court also brought despots to book and helped to deter atrocities, would there not be a net gain? It might even be good if well-meaning outsiders thought a bit longer and a bit harder before resorting to some actions, or using some weapons, to achieve their ends. Mr Milosevic, after all, has always protested that his motives were noble. He may even have believed it.

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Northern Ireland

Suspend the Assembly

Jul 5th 2001
From The Economist print edition

Unless the IRA disarms, Tony Blair should reimpose direct rule from London

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THE peace in Northern Ireland is not yet dead. This is because the IRA and its political front, Sinn Fein, have little to gain by resuming the terrorist war they ceased in 1997. But the resignation of David Trimble as the province's first minister has dealt a potentially mortal blow to the Northern Ireland Assembly the Good Friday Agreement brought into being three years ago. Under the rules for power-sharing, the resignation of the (unionist) first minister deprives Seamus Mallon, his (nationalist) deputy of his job too. Unless some deal can coax back Mr Trimble or a new leader of the Ulster Unionists, the British government will have in six weeks' time either to call new elections in the province or suspend the Assembly.

The case for suspending the Assembly is strong. The continuing failure of Sinn Fein-IRA to give up, break up or cement up a single illegal weapon has made Mr Trimble look a dupe to many Ulster Protestants for signing an agreement that turned IRA gunmen into government ministers. Gerry Adams, Sinn Fein's president, points out with perfect accuracy and magnificent irrelevance that his side has never made an absolute promise to disarm. But his point is accurate only because the IRA takes care to frame its promises in so many ambiguities that it can slither away from any undertaking. And it is irrelevant because Tony Blair, Britain's prime minister, told Mr Trimble during the Good Friday negotiations in 1998 that decommissioning was an essential part of the deal and should start at once. Suspending the Assembly is the least Mr Blair must do to keep faith with the unionists.

Suspension need not destroy the peace for good. At best, a period of direct rule from London might help Ulster to limp through the Protestants' volatile marching season, with the possibility of cooler heads agreeing to some face- and Assembly-saving deal in the autumn. Suspension has its dangers: the Stormont parliament that was suspended in 1972 has stayed suspended for three decades. But it is probably safer than to hold fresh elections. In the province's present climate, new elections are liable simply to strengthen the extremists on each side against the moderates. This is what happened in elections for the Westminster Parliament last month, when Sinn Fein and Ian Paisley's anti-agreement Democratic Unionists did better than Mr Trimble's Ulster Unionists and Mr Mallon's SDLP. A deal that eluded the two communities when Mr Trimble and Mr Mallon headed the main parties would surely be unattainable if Mr Adams and Mr Paisley took their places.

Better than either alternative would be if Mr Blair could use the threat of suspension to force Sinn Fein and the IRA into decommissioning. Conventional wisdom says that the hard men of Sinn Fein and the IRA will make no such concession when they are under the pressure of an ultimatum. But the prospect of suspension would at least force Sinn Fein to weigh what it stands to gain from keeping the institution alive against what it stands to lose by seeing it collapse. Right now, there are grounds for thinking its interest lies in saving it.

The peace has served Sinn Fein well. In the north, joining the power-sharing government of a province whose legitimacy it does not accept has not damaged its standing among Catholic voters. Instead of being punished for participating in the Stormont government, Sinn Fein is now on course to supplant the SDLP as the main nationalist party in the Assembly elections due in two years' time. In the south, the party has been edging closer to its aim of holding the balance of power in the republic's parliament. How many of these gains would be lost if the power-sharing experiment were now to unravel?

That depends on how the unravelling happens. If Mr Blair were to suspend the Assembly tomorrow, most nationalists would not blame their own lot but the reluctant power-sharers on the unionist side.To put real pressure on Mr Adams, Mr Blair must arrange matters so that he can threaten to suspend the Assembly in a way that shifts the blame to Sinn Fein.

For this, Mr Blair needs to negotiate a compromise capable of attracting the strong endorsement of both Mr Mallon in the north and Bertie Ahern, Ireland's prime minister, in the south. It would probably have to consist of IRA decommissioning in return for further reform of Ulster's police along the lines suggested by Chris Patten's commission in 1999. Mr Trimble says it would be an outrage thus to "reward" the IRA for its previous refusal to disarm. In truth, it would be a difficult offer for Sinn Fein to refuse without alienating new-found voters north and south of the border. It is certainly worth a try.

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Letters

Jul 5th 2001
From The Economist print edition

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Entertaining economics?

SIR – The complex issues before the WTO, IMF and World Bank tend to confuse and even bore the public to such an extent that it is difficult to build support for international organisations ("More tomatoes, please", June 23rd). I agree—though it pains me to do so—that protesters have indeed done what the public-relations departments of these organisations have failed to do: "they have made economics exciting."

You might have added economics journalists to the list of those who have failed to persuade the public of the exciting nature of the subject. I greatly appreciate your efforts but the great majority do not read newspapers and magazines to inform themselves on the latest developments in the fields of business and economics. Sad, but true. Perhaps the problem lies with the presentation?

Keith Rockwell
Director, Information and Media Relations Division, WTO
Geneva

SIR – The greatest irony of all is that with their mobile-phone co-ordination, web-based propaganda, cosmopolitan composition and transatlantic travel, anti-globalisation malcontents protest at the very system that spawned them (I have even seen some in Nike trainers).

Justin Tyson
Washington, DC

The long last mile

SIR – It was interesting to see your comparison of broadband rollout in various countries ("Broadband blues", June 23rd). Today, local and long-distance phone services would be little more than cheap add-ons to a monthly DSL or cable-modem service except for the obstruction of phone and cable incumbents. It is very difficult to pry the transmission and distribution system loose from incumbents. But in the transition from regulated monopoly to a deregulated model, if you do not have equal access to the last mile and the customer you do not have truly market-based competition in service, marketing or pricing.

This is also at the heart of California's energy problems; it is what you get when too many entrenched interests write a deregulation bill.

Niels Erich
San Francisco

Savings in Japan

SIR – You say that it is "wrong to take Japan's structural savings surplus as given ("Chronic sickness", June 2nd). Japan's high saving is due not just to an ageing population but also to a return on capital that is half that in America". You have confused the total level of Japan's savings with the surplus of such savings over domestic investment. In our analysis of the impact of Japan's demography, we have shown that the current level of private-sector gross savings is indeed higher than we would expect in equilibrium. This does not, however, reduce the structural surplus of savings over domestic investment,

since private investment is also above its equilibrium level to a similar degree.

You make the implicit assumption that the low return on Japanese corporate investment can be raised without cutting its level. This is highly unlikely. The proportion of corporate output that goes to profits is now the same in Japan as in America. Achieving returns comparable to America can thus only come from achieving a similar rise in output from a similar level of investment. As Japan and America invest similar proportions of their GDP in private non-residential investment, similar profitability requires similar growth rates. There is, however, a 2%-a-year difference between the rise in the working population of America and the fall in Japan. For the two to have similar growth rates thus requires Japan's labour productivity, measured in terms of output per head, to rise by 2% a year faster than America's.

This is highly improbable and its improbability is not lessened by vague claims that "corporate restructuring would shift resources to more productive uses". The pursuit of higher returns by Japanese firms requires domestic investment to fall. Thus, even if a rise in the return on investment reduces the level of domestic savings it will not lead to a reduction in the surplus of such savings over investment.

Andrew Smithers
Smithers & Co
London

Houston, you have a problem

SIR – Enough hype about Houston ("The blob that ate east Texas", June 23rd). People who live there do not want to stay and people do not want to move there. I am preparing to take the bar exam in California, and if you look at where the bar-review classes are being offered you can judge how much interest Texas holds for out-of-staters. The Texas bar review is offered in no other states. The number taking the bar in Texas (roughly 2,000) is about 800 more than Georgia (with only one big city) and roughly the same as Florida (with a much smaller population). California has 12,000 applicants and its bar-review courses are held in many other places (including Provo, Utah, Ann Arbor, Michigan and even Austin, Texas).

A global city needs to retain and attract highly educated people, and needs to be cosmopolitan both demographically and in attitude. People from California or New York would not mind moving to London or Tokyo but would balk at moving to Texas. Houston's downtown district is boring and its neighbourhoods aesthetically displeasing. The heat and humidity are overbearing. Add to this the conservativeness of the South, lack of smart young people and good educational institutions, a dearth of natural beauty and mediocre shopping. Houston has little to offer unless you are a fan of country music, big hair or cowboy boots.

Audrey Cheng
Washington, DC

The heat is on

SIR – You are right to argue that the Kyoto climate treaty is not perfect but your solution—extending the deadlines by which reduction targets should be met—is inappropriate ("A warm reception", June 16th). It would impose unfair economic disadvantages on countries that spent money to boost energy efficiency standards or renewable energy. Scientists estimate that carbon-dioxide emission must be cut by at least 60% by 2050. Friends of the Earth calculates that industrialised countries would have to achieve reductions of 80% in order not to exceed their fair share of the planet's environmental space. How will such cuts be possible if we do not even achieve the cuts the Kyoto treaty demands by 2012? Prudence teaches us, if in doubt, to err on the side of caution. If Kyoto were to be renegotiated, reduction targets and timescales would, if anything, have to be tightened.

Daniel Mittler
Friends of the Earth Germany
Berlin

SIR – How many scientists who say that global warming is a fact and is probably due to human activity have a vested interest as their funding depends on scaring the public? And what reason do we have for thinking that global warming would be bad? Do not historical records show that the last warm period—the 12th century—was fairly good?

Robert Otto
Crystal, North Dakota

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Between here and there

Jul 5th 2001 | CIUDAD JUAREZ-EL PASO AND TIJUANA-SAN DIEGO
From The Economist print edition

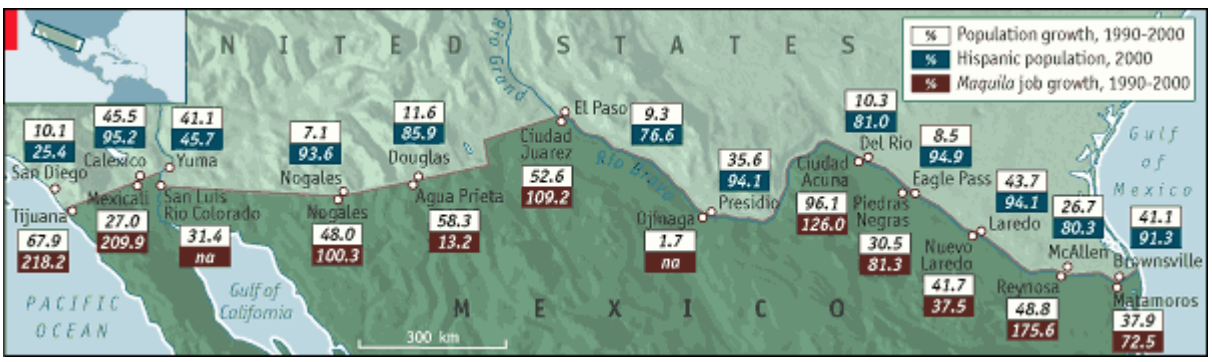
Joe Raedle/Newsmakers

The border region between the United States and Mexico is growing so wildly that a new way must be found to govern it

TWO bullet holes decorate the driver's door of the car that has just pulled up: neat black craters with silver coronas of flaked-off paint. It is a chilling reminder that this is Tijuana, the host-city of Mexico's most powerful drug mob, where over 300 people were murdered in 1998, most of them in gangland shootouts. But the driver chuckles. "They're fake," he says. So they are: the holes are solid metal, the "missing" paint artfully brushed on. Gallows humour, Tijuana-style.

An ability to laugh at things that scare their compatriots is not the only thing that distinguishes border-dwellers. The taxis are big American clunkers whose drivers listen to American radio stations. A shop sells bottles of American-made *horchata*, a traditional Mexican rice drink—but strawberry-flavoured, the way no traditional Mexican drinks it. Spanish melds with English: a government official asks his assistant to *faxear* a letter to someone. Lunch is at 1pm, not 2 or 3. Appointments are kept. Cars stop for pedestrians—sometimes.

Both Mexico and the United States find the border zone rather foreign. To Americans it is a quaint, impoverished land where everyone speaks Spanish; to Mexicans, a reckless place, haunted by drug traffickers and *coyotes* who promise migrants an easy crossing and leave them for dead in the desert. In return, border-dwellers on both sides often feel less close to their countrymen than to the people across the line. Many have family there, and perhaps a tenth cross over every day. There is border music (*norteño* bands that sing about bandits, and fusions of *norteño* with techno from the San Diego nightclubs), border art and even bilingual border films, of which this year's "Traffic" is merely the latest. Pairs of border cities are economically intertwined, sharing not only the same air and water but some of the same social ills. Thinking of the border as a separate country makes some kind of sense.



A strange country it would make, and not just because of its shape (see map). At the western end it is half-Anglo, at the other almost totally Hispanic. It is richer than Mexico, poorer than the United States, but booming. It has gone from being largely agricultural to mainly industrial in 30 years. In the past decade its population has swelled by 30%. GDP growth (for the border states on both sides) is averaging between 5% and 7 % a year. Yet despite its prosperity, it cannot provide electricity, roads, schools or housing fast enough, it is riddled with crime, and large parts of it risk running out of water in the next couple of decades. And nearly 400 people died last year trying to cross from one side of it to the other.

Of course, the border is not a single country. And that is its problem. It is a series of paired cities strung out across a vast tract of wilderness. These cities must go separately to their far-off federal governments in order to tackle joint local issues. And although they have things in common, the Mexican and American border regions are also very different. The side with the bigger changes, and the bigger dificulties, is the Mexican side.

Build it, and they will come

Forget, for a moment, the 300,000-odd Mexicans who enter the United States illegally each year. Forget, also, the ones who fail. It is a myth, studies have found, that they wind up living in one of the Mexican border boomtowns. After a few tries, they usually go home to their families. Instead, consider the many more—671,000 in 1997—who head north planning to stay on the Mexican side of the line, at least for a while. It is a growing tide. In 1990 around half of would-be migrants did not aim to cross the border; now 60% do not.

This flow will soon turn the border bottom-heavy. In a decade the population on the Mexican side has increased by nearly half, compared with one-fifth across the boundary. It has also become more bunched. Just 13% of the people live outside the ten biggest cities. At their current rates, Tijuana will double in size in 12 years, Ciudad Juarez in 15 or 16.

In a decade the population on the Mexican side has increased by nearly half, compared with one-fifth across the boundary

They come, single men and women or entire families, from big cities or tiny villages the length and breadth of Mexico, to work; above all, to work in the *maquiladoras*, the factories that make products from duty-free imported parts for re-export, mostly to the United States. The *maquiladoras* were devised in 1965 as an alternative to the *bracero* programme, then just ended, that allowed a number of migrant Mexican farm-workers into the United States. They were meant to reduce migration, but instead they redirected it. Since then the export boom set off by the North American Free-Trade Agreement (NAFTA), which took effect in 1994, has swelled it. Border-state *maquiladoras* now employ over 1m people, an increase of 150% since 1990.

Horror stories are told about the *maquiladoras*. In fact, many have improved their working conditions in recent years and given employees more benefits. Yet according to a study by Jorge Santibañez and Rodolfo Cruz at the College of the Northern Border (Colef) in Tijuana, real wages on the Mexican side of the border have dropped overall since 1995, when the peso was devalued, while on the other side they have risen. On average, an American border worker makes three to four times what a Mexican does, up from 2.5 times in 1990. In certain jobs, it can be 12 times as much. Moreover, although a new “third generation” of *maquiladoras*—factories that do design as well as assembly—employs more highly-skilled workers, another Colef study has found that they are not, on the whole, getting higher wages.

Real wages on the Mexican side of the border have dropped overall since 1995

This suggests that wages were not only hammered after Mexico’s 1995 economic crisis, but continue to be squeezed to compete with Asian countries. Yung Kwon, the former president of Samsung Electromechanics of America, who oversaw its plants in Tijuana, says that productivity is lower in Mexico than, say, China or Thailand, and that Asian companies come to Mexico only because the United States market is close by. When that market falters, so do they. Since the slowdown began in the United States, nearly half the Mexican jobs lost have been in the *maquiladoras*. Another incentive, the duty-free import regime, was due to expire at the end of last year, but the government has conceded breathing-spaces of up to a year, worried that the end of privileges will drive the factories away altogether.

“The *maquiladoras* will not grow again at the rates seen in the 1990s,” predicts Mr Cruz. To some, this is welcome. *Maquiladoras*

AP

are criticised not just for exploiting labour and producing toxic waste, but also for contributing little to the wider economy. Over 97% of their supplies come from outside Mexico. Since they are often foreign-owned, and are bent on shipping products out as cheaply as possible, they have historically had little or no interest in developing infrastructure, local skills or education, says Charles Nathanson of the San Diego Dialogue, a think-tank on regional development. Their unplanned, parasitic boom has made the border what it is today.

Mayan sun-god at home: El Paso, Texas

Streetlamps in the desert

The *colonias* of Ciudad Juarez stretch for miles into the roasting, yellowish plains of the Chihuahuan desert. The farther away from the city, the bumpier the dirt roads, the more ramshackle the houses, the bigger the piles of rubbish. Suddenly, just beyond the last and most tumbledown *colonia* of all, there is a bizarre sight: a neat forest of streetlamps in the middle of the desert, patiently awaiting streets and houses to illuminate.

The streetlamps are the city's attempt to reverse the normal order of things. Most of the *colonias* began as illegal settlements thrown up by migrant workers, who then petition or fight local councils to get services. The fights are long. Alejandro Perez of the Study Centre and Labour Workshop, a local labour-rights organisation, lives in a district that was founded 35 years ago with the first *maquiladoras*, but has had running water only for the past decade. Usually, residents must share the cost of roads, electricity lines or piping. "And yet," notes Mr Perez wryly, "the city is full of great big avenues so we can all get to work on time."

Everyone agrees the biggest concern is water

The biggest concern, everyone agrees, is water. The border region depends on two rivers: the Rio Bravo (Rio Grande), running down from the Rocky mountains, along the border and into the Gulf of Mexico, and the Colorado river, which follows the boundary between California and Arizona down into Mexico before spilling into the Gulf of California. A binational treaty says how much of their water each country can use, but the supply is running short, exacerbated by several years of drought in the centre of the region. The Rio Bravo is so weak that it dries up just short of the beach near Brownsville. In some towns, only half the population has running water and slightly more are connected to the main sewer.

There are underground aquifers, but they are not in the treaty, so cities on both sides tend to overuse them, turning them salty. The aquifer under Ciudad Juarez-El Paso will run out within the next 25 years, and both cities are looking at either desalination plants or new aquifers. Either will be expensive.

Services are overstretched in the American border cities too. But several things make life more difficult for the Mexican ones. Almost all their money still comes from federal or state government. How much they get depends on their populations, which are hard to count because so many people are just passing through. The United States' clamp-down on illegal immigrants, and the corresponding increases in the prices charged by *coyotes*—from $300 or so in the early 1990s to as much as $2,000 today—have not discouraged any from trying, but merely forced them to hang around longer in the border towns.

The official population figures are routinely inflated to try to win more resources; last year's census is already being decried as an undercount. Worse, a lot of people work across the border, paying taxes in America but using services in Mexico. Some 80,000 Tijuanans commute across the line every day. Worst of all, the law forbids Mexican cities to get into debt.

One place they can turn to for more resources is the Border Environment Co-operation Commission (BECC) and its associated North American Development Bank. These were created, along with NAFTA, to help pay for water, sewerage and better waste treatment on both sides of the line. So far the bank has authorised $276m for $870m-worth of projects.

But, says Franco Bareno at the BECC, it would cost $2 billion-3 billion just to get all the Mexican border towns equipped with basic water and sewerage services. To bring all their essential infrastructure up to scratch, estimates Ernesto Ruffo, Mexico's border commissioner—a post created seven months ago by

President Vicente Fox—would require an immediate $18 billion, or 3% of Mexico's GDP.

Toxic waste is yet another matter. Now that the *maquiladoras'* duty-free regime is ending, their waste will have to stay in Mexico instead of being returned abroad. Mexico has only one fully-equipped refinery for industrial toxic waste, and according to one government estimate, a mere 7.5% of the stuff produced in Mexico is properly registered. Treatment plants are thus a big business opportunity. But there is also the risk, say environmentalists, that a lot more *maquiladoras* will simply start dropping their leftovers in city dumps.

The border's explosive growth also brings social problems. New arrivals come without the extended families and social fabric that held their villages together. Ciudad Juarez, for instance, has ten day-care centres, each catering for a few hundred children, although 180,000 women work in the factories. Traditional roles are shaken up. "The men undergo a huge change when their wives start working. They lose their role as the provider, and that frustrates them," says Esther Chavez, whose Casa Amiga women's centre in Ciudad Juarez deals with more and more domestic violence.

Crime, much of it related to drug trafficking, is high, and the justice system is overburdened. Ms Chavez compares the number of murders in the city—183 last year, less than half resulting in even a prosecution—with that of El Paso across the way: nine murders, all solved.

Crime, much of it related to drug trafficking, is high, and the justice system is overburdened

Drug-taking, though much less common than in the United States, is also particularly high on the border. The proportion of people who have tried drugs in Tijuana is nearly triple Mexico's national average, according to Gady Zabicky at the National Psychiatry Institute. At the Centre for Mental Health in Mexicali, over half of last year's patients had mental problems caused by drugs, up from 15% in 1999.

The big incentive to try drugs is their cheapness and availability on the border. During the late 1980s and early 1990s, Mexican drug lords faced with cash-flow problems started paying their couriers in kind, flooding the borderlands with cocaine, heroin and methamphetamines. The doctors in Mexicali say a dose of crystal meth costs as little as 20 pesos ($2.20), and a shot of heroin 50 pesos.

Despite all this, most of the people who come to the *colonias*, enduring the two-hour bus rides to work and cobbling together a dwelling out of spare and stolen materials, will say that they are better off than where they came from. The grimness is not unmitigated. The*maquiladoras*, in particular, are becoming more socially and environmentally aware. Some pitch in with the government to build cheap housing and help workers pay for it with financing schemes—essential, since credit is scarce in Mexico. And as small-scale Mexican agriculture disintegrates, partly because of competition under NAFTA from huge American farms, millions are finding a precarious urban life better than a rural one with no money at all.

Not everywhere is overrun by *maquiladoras*. On the whole, they have taken hold where a local industry, such as agriculture, is flagging. Mexicali, for example, used to be a farming town, and many residents still cross the line to work in the lush Imperial Valley, north of Calexico. But now the factories are feeding its growth; in turn, says Jose Maria Ramos at the Mexicali branch of the Colef, the city feeds 80% of Calexico's services and commerce.

On the other hand, take Nuevo Laredo. Along with Laredo, its cousin in Texas, it has long been the busiest crossing point for trucks, with all the associated services they require (and congestion and pollution too). Or Piedras Negras, a town founded on mining and electricity generation. Both towns offered better-paid, more stable jobs than the *maquiladoras* could, so they have grown more organically; they have fewer factories, and fewer people without running water and sewerage.

But in every case, national issues can have sharp local effects. Because of their economic links, a slowdown in the United States will hit both Mexicali and Calexico hard. Nuevo Laredo has done well partly because Mexican truckers have not, up to now, been allowed to drive far into the United States, so they have to stop in the town to transfer their loads to an American rig. A NAFTA tribunal recently ruled to end the ban on Mexican drivers; when that comes into force and the truckers can drive straight through, a lot of the town's business may dry up.

One head is better than two

Pairs of border cities sometimes try to collaborate rather than going through the bureaucracy of

Washington or Mexico city. But this is usually to solve small problems rather than to plan long-term. Even then, the international boundary can get in the way. El Paso's firemen once responded to an emergency in Ciudad Juarez, only to realise that their life insurance did not cover them across the border.

There are also countless groups for cross-border co-operation, from official bodies such as the BECC to business associations, governors' meetings, academic societies and cultural and environmental organisations. But, like the city councils, they are hogtied. Big decisions on public projects must be made, often by diplomats, a thousand miles away.

Decisions on public projects are often made by diplomats thousand of miles away

It is a shame, for a poor and a rich country side by side have some great opportunities for collaboration. For example, Tijuana and San Diego both need new aqueducts to bring water from the east. "They should build one together on Mexican land, with Mexican labour and American financing," says Mr Nathanson of the San Diego Dialogue. "But the politics makes it very complicated."

By creating a border commissioner, Mr Fox has recognised that the border needs special attention. Mr Ruffo has ideas for how to win financing, create yet more bi-national bodies (such as an independent water authority) and lay the groundwork for regional planning. But he has no executive power. He can only listen to the local politicians and in turn try to bend the ears of federal ones, to wheedle some extra money here, another road there. And although Mr Fox has promised more decentralisation, neither country has floated ideas for how to make it easier for cross-border cities to work together. If all that vibrant cultural mixing is to be turned into something prosperous and substantial, this is what must happen next.

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About sponsorship

Stem-cell research

The cutting blob of ethical politics

Jul 5th 2001 | WASHINGTON, DC
From The Economist print edition

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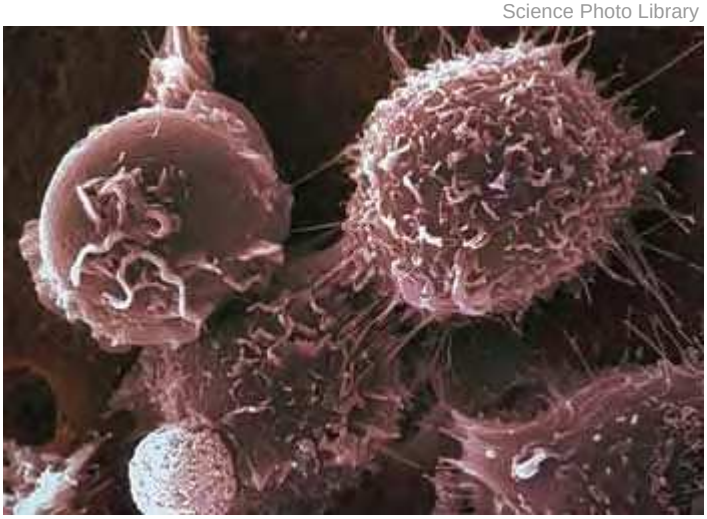

America's complicated argument about stem-cell research could be a forerunner of bigger fights to come

GEORGE BUSH has come face to face with the first policy dilemma of the new world of human genetic engineering: should the federal government finance research into stem cells derived from human embryos? Stem cells can transform themselves into the many different cell types that go to make up a body. They hold out the promise of new therapies for diseases like Parkinson's or Alzheimer's. But because such cells are derived from embryos, their extraction upsets many (though, crucially, not all) anti-abortion people .

The stem-cell issue, the first to divide publicly members of Mr Bush's government, dates back to 1998, when researchers at the University of Wisconsin isolated stem cells from embryos. But because Congress attached a special provision to a budget bill in 1995 banning the use of federal money for research in which human embryos are created or destroyed, no public money is involved.

In its last year in office, the Clinton administration proposed new guidelines to get round this restriction on the basis that it applied to embryos not stem cells: scientists could get federal money to conduct research into stem cells, as long as they personally did not destroy embryos to do it. The effect of this change was limited as there was little money available, so Mr Bush could have fulfilled his campaign promise to ban federal spending fairly painlessly if he had done it immediately (just as Mr Clinton reversed a ban on fetal-tissue research on his first day in office).

Instead, influenced by Connie Mack, a former Florida senator who is Catholic, conservative, strongly anti-abortion and a supporter of stem-cell research, Mr Bush said he would take a decision based on a new review of the scientific and ethical issues. Part of that review, from the National Institutes of Health (NIH), came out last week and affirmed the promise of "a dazzling array" of possible treatments. As *The Economist* went to press, the president's decision was rumoured to be imminent.

Federal funding matters partly because of the cost of the research. John Gearhart of Johns Hopkins University, one of the pioneers of the science, says it could cost $100m or so over the next five years to conduct the research properly. The leading private company involved, Geron, of Menlo Park in California, had sales of just $6m last year.

Just as important is the signal federal approval sends. The complexity of stem-cell research means it would be best conducted by many laboratories bombarding the stem cells with as many different tests as possible. The network of federally financed laboratories is better suited to that work than competing private ones. And federal backing might attract bright sparks into the field, and prevent others from going to places like Britain (where the government has recently permitted new embryos to be created through cloning for the specific purpose of cultivating stem cells).

Critics say stem-cell research is immoral, illegal and unnecessary

Critics of federal funding make three arguments. First, they say, stem-cell research is immoral. Embryos are human life. You cannot (yet) reliably extract stem cells from them without killing them. The fact that research into embryonic stem cells will initially be conducted on cells from embryos discarded in the course of *in vitro* fertility treatments is irrelevant. These are still potentially human beings, and anyway they doubt whether scientists would content themselves with "discarded" embryos only. Second, they say, stem-cell research is illegal—that is, against the terms of the 1995 provision. The Clinton guidelines are merely trying to subvert the law.

Third, they argue that embryonic stem-cell research is unnecessary. Stem cells can also be found in small quantities in many adult tissues, such as the brain. The same benefits can be realised through research on "adult" stem cells, which do not involve killing the donor. These cells, they claim, show the same ability to reproduce repeatedly as embryonic stem cells, and can also differentiate themselves into a variety of cell types.

Supporters of federal funding differ on all three counts. It is simply not true, they say, that adult stem cells are an adequate substitute. For obvious reasons, adult stem cells are difficult to harvest routinely from some living organs, such as the brain or liver. They are harder to grow in the laboratory in the quantities needed for transplantation and, especially, tougher to push into becoming a variety of cell types. Because of that, even adult stem-cell work may have to depend on instructions learned from embryonic stem cells. The scientific consensus, exemplified by the recent NIH report, supports this view.

Next, supporters of funding naturally accept Mr Clinton's legal definition, and make a further point about the legal advantages of federal involvement. Now, stem-cell research, like a good deal of genetic science in America, is conducted in private laboratories (and thus barely regulated). Given the unease about things like cloning, would it not be better if there was more public oversight, which federal money would entail?

Third, the supporters differ on the moral issues. The stem-cell debate is much more complex than that hardy perennial of American ethical dispute, abortion. The abortion debate hinges solely on your attitude to the cells that make up an embryo or fetus. Supporters of abortion rights, who think embryos are not meaningfully persons, can carry the same logic forward to stem cells effortlessly. But for anti-abortionists, the issue is harder, since it requires balancing two "pro-life" goods: the life of the embryo against the potential lives saved from research based on its stem cells.

Not all anti-abortion activists think that balance comes down against research. Connie Mack is one. Orrin Hatch, a senator from Utah who opposed research on fetal tissue on pro-life grounds, and Tommy Thompson, Mr Bush's health and social services secretary, are in the same group of pro-stem-cell Republicans. And the polls show around 58% of Americans and 54% of Catholics support stem-cell research.

But one group does not: regular church-going Catholics. Deal Hudson, the editor of a magazine, *Crisis*, who advised Mr Bush on Catholic voters during the campaign, points out that Catholics who go to mass once a week are seven to ten points more "conservative" on moral issues than other Catholics. That would suggest a majority of those who take mass once a week oppose the research—and since there are 14m of them, and since Mr Bush polled extraordinarily well among all Catholic voters in the election, they are not simply to be ignored. No wonder Karl Rove, the president's chief strategist whose job it is to make these raw political calculations, has emerged as the main opponent of stem-cell research in the White House.

Two compromises have thus emerged. One would confine federal money for research into "discarded" embryos already in fertility clinics. Conservatives oppose this, saying these embryos could still give life. The other more likely one would allow federal funding—but only on those stem-cell "lines" already derived from embryos. Scientists dislike this. Mr Gearhart worries that it restricts research to a narrow genetic pool (there are only a dozen or so such stem-cell lines) and points out that no one really knows whether stem cells can replicate themselves endlessly without any deterioration in quality.

Jeffrey Kahn, the director of the Centre for Bioethics at the University of Minnesota, argues that this solution does not resolve the moral issue anyway because these are embryonic stem cells, so public money would still be spent on research that depends on destroyed embryos. To that, Mr Hudson replies that at least no new life would be destroyed, and most scientists would probably say that some federal money is better than none.

If that were the shape of the compromise, it would speed up stem-cell research to some extent, which is necessary because the work is in its infancy. But if the hopes of the scientists are realised, and stem cells do indeed promise a medical revolution, then the compromise would merely postpone the toughest decision: whether to allow the creation of new embryos—by “therapeutic cloning”—to create the millions of stem cells needed to realise the full potential of the research. Whatever Mr Bush decides this week, the arguments are only going to get more bitter.

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Snowmobiles

A year's grace?

Jul 5th 2001 | YELLOWSTONE NATIONAL PARK
From The Economist print edition

The smoke and noise can go on, for a bit

THE snow has melted, and the row over the machines that rocket through it in the wintertime has, at least for the moment, been settled. Snowmobiles, it has been decided, may be ridden in Yellowstone Park for at least one more year.

AP

Tourist or terrorist?

Two years ago the National Park Service (NPS) announced that it would phase out snowmobile use in 27 national parks by 2004. Snowmobile manufacturers appealed against the decision, claiming the NPS had used "junk science" in reaching its decision. On June 29th the federal Department of the Interior, which has jurisdiction over the NPS, signed a stay-of-litigation deal and agreed to consider new data about snowmobile pollution. The NPS has admitted that it used inaccurate figures for carbon-monoxide emission.

Conservation groups such as the Greater Yellowstone Coalition are furious. "We've had 13 years of study," says that group's Jon Catton. "To say we need another study is tantamount to saying we want snowmobiles in Yellowstone no matter what." Of the 180,000 snowmobiles that entered all national parks last year, 62,000 went to Yellowstone; and tens of thousands of people, according to Mr Catton, have said how much they would prefer not to have them there.

Snowmobiling is big business, bringing in more than $10 billion a year to the people who make snowmobiles or arrange snowmobiling holidays. Unsurprisingly, not one senator or representative from Wyoming, Montana or Idaho endorsed the NPS's original prohibition. But snowmobiles produce pollution as well as profit. Their whining, smoke-belching two-stroke engines generate between 70% and 90% of all the hydrocarbons and anywhere from 35% to 68% of all the carbon monoxide released in Yellowstone. The first snowmobile entered Yellowstone in 1963. In 1972, President Richard Nixon signed an executive order telling the parks to exclude snowmobiles unless they chose to confine them to a given area. Glacier National Park in Montana and Yosemite National Park in California put a total ban on the machines. In 1977, President Jimmy Carter signed another order prohibiting snowmobiles where they damage wildlife or the habitat.

The snowmobile industry responded glacially. It was not until 1994 that it hired the San Antonio-based Southwest Research Institute to explore ways to reduce snowmobile emissions. In 2000, Arctic Cat introduced the "Yellowstone Special", powered by a four-stroke Suzuki engine that is "as quiet as a car", in one rider's view, and emits much less pollution—though exactly how much less is not clear.

In 1999,Yellowstone had 3.1m visitors, almost twice as many as when snowmobiles first got there 36 years earlier. The park's former superintendent, Mike Finley, who handed in his retirement letter in June, says that the Yellowstone administration was left out of the decision-making process about snowmobiles. If consulted, says Mr Finley, who regrets the daily "harassment of wildlife by over 2,000 untrained snowmobile drivers", the park would have resisted the Department of the Interior's recent decision. "Cleaner is not clean. Quieter is not quiet."

Mr Finley and those who feel like him can take comfort from the fact that the snowmobiles have got only a one-year reprieve. Grizzly bears and wolves have won protection at the expense of ranchers and nervous locals. Snowmobilers, on no endangered-species list, may not prowl all that much longer.

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About sponsorship

The tabloid press

Pass the Pulitzers

Jul 5th 2001 | WASHINGTON, DC
From The Economist print edition

The case of the missing intern points to the power of the supermarket tabs

A FEW years ago, Hollywood produced a film based on the amusing (and not implausible) premise that aliens from outer space had been living on earth for years, particularly in New York. The heroes of "Men in Black" were immigration officers whose job it was to keep an eye on these extra-terrestrials. The only help they had in this difficult task, beyond a fine array of machineguns, was the tireless reporting of the tabloid magazines—"the best investigative journalism in the world," as one of the characters says.

EPA

Condit, the quarry

Back in the real world, the weekly tabloids have this year been responsible for more hot political scoops than any of the mainstream media. In January, the *National Enquirer* broke the story of Jesse Jackson's illegitimate child. In February, the *Enquirer* vied with Associated Press to be first with the news that Hillary Clinton's brother, Hugh Rodham, had received $400,000 for his help with two presidential pardons. Then, with admirable bipartisanship, the *Enquirer* went after the Bush family, chasing the unfortunate Jenna on both drink and marijuana.

Now the tabloids are making the running in a story that has set Washington abuzz: the story of Chandra Levy, an intern who is rumoured to have had an affair with her Democratic congressman, Gary Condit (who denies the whole thing). She has now been missing for more than two months. This week, the *Star* clobbered Mr Condit again with allegations that he had also had an affair with an air hostess, and that he had tried to persuade her to sign a statement that they had never had a "romantic relationship".

There is nothing particularly new about the tabloids being good investigators. They made the mainstream media play catch-up with a series of scoops during the O.J. Simpson trial, producing, for example, a picture of Mr Simpson wearing a pair of Bruno Magli shoes that he claimed he had never owned. And they have aimed at political targets before: the *Star* took Dick Morris's scalp in 1996 when it revealed that he was having an affair with a prostitute, and almost torpedoed Bill Clinton's presidential campaign in 1992 when it unveiled his affair with Gennifer Flowers. But hitherto they have only dipped a toe into the political pond. The latest spate of stories suggests that they are looking at politics with a new seriousness.

Why forsake Martians for politicians? The simple answer is readership. The *Enquirer's* circulation has sunk from 3.1m in 1994 to 2.1m, the *Star's* from 2.8m to 1.6m. Supermarket chains become nervous about stocking tabloids if their circulation falls below 2m.

Circulation is down partly because readers seem, quite astonishingly, to mistrust the tabloids' accuracy. Only one out of every eight people who flip through the pages of a tabloid on the way to the checkout counter actually bothers to buy one. Meanwhile, the people who originally got into the habit of buying the tabloids to read about the latest sightings of Elvis are beginning to die off. The mainstream media are invading the tabloids' territory with gossipy entertainment channels and endless chat shows that blur the distinction between speculation and news.

David Pecker, who has run American Media Inc's tabloid empire since 1999, is spending millions in an attempt to recruit new readers and advertisers. He has presided over a dramatic consolidation of the industry, leaving him in control of all the weekly tabloids. He is increasing the amount of firepower his group devotes to investigative journalism: the *Enquirer* set a dozen reporters on to

"No Elvis. No aliens. No UFOs," promises the Enquirer

the task of dissecting Mr Clinton's ten most questionable pardons. And he is dealing with the credibility problem by carefully segmenting his market. The *Enquirer* is aiming at the top end. The paper's delivery vans have the slogan "Get it first. Get it fast. Get it right" printed on the back, and "No Elvis. No aliens. No UFOs" on the side. (The *Weekly World News*, which has led the pack with sightings of Elvis, continues to focus on traditional tabloid fare.)

The tabloids' job is made easier by two things. The first is the blurring of the line between sensationalism and politics. The line was always going to be hard to defend in an era of proliferating news media. But it has been erased by Mr Clinton's priapic tendencies. The tabloids are arguably the papers of record of the Clinton years.

The second factor is the prissiness of America's broadsheets, still the only form of daily newspaper in most of the country. New York city is the only place with a daily tabloid press that a European would recognise. Many of the country's top journalists think that their job is to analyse "policy"; they do not wish to discuss, in print, tittle-tattle about "personality".

Interested public, or public interest?

Such high-mindedness may have its merits, but the supermarket tabloids do not share it. They say the job of the press is to expose the personal failings of the powerful as well as to discuss greenhouse gas emissions. They instinctively realise that President Bush's tough stance on marijuana makes the question of whether his daughter has ever smoked that weed a compelling news story. (Texas sends people caught with two ounces or less of marijuana to jail for 180 days.)

The case of the missing intern is manna from heaven for the new-look tabloids. It allows them to link their new-found interest in politics with their long-standing obsession with sex and murder. It also allows them to use the sort of investigative techniques that mainstream newspapers eschew. The *Star* discovered about Mr Condit's friendship with the air hostess by paying the latter's room-mate $2,500 for the information.

The missing-intern case has allowed tabloids to link politics, a new interest, with the usual sex and murder

For the moment the tabloids are on a roll. The issue of the *Enquirer* that broke the Jackson story was one of the paper's most successful. More up-market advertisers have started taking out ads in the paper.

Will this continue? Some speculate that the tabloids' flowering is really just a relic of the Clinton years: a more upright (and less charismatic) president will be the death of them. This seems unlikely. Even supposing they fail to dig up any new scandals, a quick glance at a list of the tabloids' current victims—Mr Jackson, Mr Condit, Marc and Denise Rich, Rudy Giuliani and, of course, the Clintons—reveals a lot more questions than answers. The Condit issue will not disappear until the intern is found.

And the tabloids still tackle the questions that higher-minded journalists steer clear of in their writing but then spend most of the week discussing at lunch. The latest *Globe* reports that Mr Clinton plans to tell everything in his memoirs, including the crucial "facts" that he "was a battered spouse who suffered physical abuse at Hillary's hands for years", that he had a secret mental breakdown after telling his daughter about his affair with Monica Lewinsky and, surprise surprise, that he's a sex addict. *New York Times*, please do not copy.

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Asian high-tech workers in America

Byting more than they can chew

Jul 5th 2001 | FALLS CHURCH, VIRGINIA
From The Economist print edition

Technology firms are finding some of their foreign recruits hard to shed

WHEN times get tight, Americans have often turned on immigrants. As the American economy slows once again, xenophobia has returned. Yet this time the foreigners under attack are highly educated, middle-class computer wonks, with the resources to fight back.

In 1992, the United States began its H-1B visa programme in response to a shortage of skilled labour. Under H-1B, American companies can search overseas to find workers in “specialty occupations”, which includes researchers, high-tech staff and, somewhat surprisingly, fashion models. H1-B visas last for six years; after that, people can apply for permanent residence and, eventually, citizenship.

Since 1992, roughly 640,000 H1-B foreign workers, mostly from India and China, have been admitted to America, where they often make 20 times what they earned at home. Many Asian temporary workers are brought to America by “job shops”, which then farm the H-1Bs out to high-tech companies. As the labour market tightened in the late-1990s, job shops offered H-1Bs big signing-up bonuses, limousine rides from the airport, and other benefits to entice them to America.

Now Silicon Valley is flooded with pink slips, and Asian H-1Bs are vulnerable. An H-1B visa expires as soon as the holder gets laid off, so newly unemployed H1-B workers must scramble to find a new job within days, or risk deportation. The number of new H-1B workers has fallen by half this year, and in March and April at least 2,000 Indian high-tech professionals went home. In Falls Church, a suburb of Washington, DC, with a high proportion of Asian tech workers, message boards are full of “for sale” signs offering cars, apartments and other attributes of a middle-class American life.

For those who stay, life has also got tougher. Knowing the precarious nature of the Asians’ status in the country, their employers can easily bully H1-B people to accept lousy pay deals (“indentured servitude”, whines one). And Asian workers have to deal with complaints from their peers about stealing American jobs and depressing salaries.

This is a familiar story. But, unlike previous poorer immigrants, the H1-B crowd is not taking its misfortune lying down. Many Indians and Chinese refuse to go home, for fear that their friends will call them failures. Instead, they are taking lower-paying service jobs, trying to enlist in American universities, aggressively marketing themselves as consultants—and complaining loudly.

Roughly a quarter of Silicon Valley’s companies were founded by people of Indian or Chinese descent, so they have clout. They have formed community organisations, such as the Immigrants Support Network, to help keep temporary workers in America; they lobby Congress for looser visa restrictions; and they are calling for deportations to be considered on a case-by-case basis.

And a few H1-Bs are using the most American of all tactics: they are suing. Xija Chen, a Chinese computer scientist living in southern California, has filed suit against his former employer, PricewaterhouseCoopers, which laid him off in early May. Mr Chen claims that the company was too slow in helping him move from H-1B status to permanent residence, which would have allowed him to remain unemployed without being deported. Other H-1Bs may follow Mr Chen’s lead.

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About sponsorship

An immigrant's tale

Fresh off the boat

Jul 5th 2001 | SAN FRANCISCO
From The Economist print edition

A correspondent offers a snapshot of her new homeland's welcoming party

TIRED? Sometimes. Poor? Certainly. Huddled, homeless, or tempest-tossed? Not a bit. Your correspondent, a scrap of wretched refuse from the shores of India, became a citizen of the United States last month, alongside 1,500 other new citizens at a ceremony in San Francisco. Given the unexpectedly bizarre mingling of cant and ritual, it made more than practical sense that the event took place in the city's Masonic Centre.

The citizenship oath represents the culmination of a bleak obstacle course set by the Immigration and Naturalisation Service (INS). During the two years while your application is being processed, you have to send your fingerprints to the FBI, you are questioned on American history and asked to declare a willingness to serve in the American armed forces. On entering the hall, you have to state whether you have become a communist, a drunkard, a panderer or a wife-beater in the ten weeks since your last interview. (Deny everything; after the ceremony, head for Vegas.)

Once the oath has crossed your lips, though, the INS lays down the welcome mat with gusto. An opera singer, recently Chinese, is requisitioned from the crowd to sing the national anthem; a woman from Iraq (strongly emphasised by the master of ceremonies) is asked to recite the pledge of allegiance. Finally, in ringing tones, an official points out that as a newly minted citizen you can now sponsor the applications of your family members.

Despite the Kafkaesque delays created by INS bureaucracy, in 1993-2000 more than 6.9m immigrants applied for citizenship, a number that exceeds the total in the previous 40 years combined. Many of those are now trying to bring in their relatives. And on the very day when your correspondent was finally clasped to America's hunky breast, the House Judiciary Committee was fretting through a hearing on "guest" visas for Mexican workers.

There are now at least 5m illegal immigrants in America. Many of the participants in San Francisco were one once. One reason why America's immigration law is a mess is that illegal immigrants beget legal ones, both literally and figuratively. Most parts of the government try to fudge the differences between the two sorts. Welfare officials, for instance, scratch their heads over how to provide care to (legal) children but not their (illegal) parents.

But the INS's purpose is to maintain a sharp distinction between legal and illegal, and between citizen and "alien". Before the ceremony, you are brusquely handed yet another set of forms. After the oath, with beaming faces and irony-free applause, the same officials congratulate applicants whom they and their sort have tortured for years.

These muddled messages carry on right until the finish, when a local politician and former colonel bellows his advice on cultivating American values. The listeners receive his exhortations—to vote faithfully, attend church and seize opportunities—in respectful silence. That may be misleading. When your correspondent asked her neighbours for a pen, nobody understood English.

At the end the colonel issued what was perhaps the most basically American instruction of the lot: he told his audience to rise and greet the total stranger in the neighbouring seat. After a pregnant pause, sheepish handshakes and the occasional hug were traded, and the colonel beamed benevolently from the podium. He then bade his listeners to go forth and "engage with" their new country. He did not, as he might have done, bid them to go forth and multiply. But don't worry: we will.

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Lexington

Graven images

Jul 5th 2001
From The Economist print edition

The perils of worshipping the Founding Fathers and—far worse—living congressmen

IS AMERICA a nation of idolators? It is perhaps a little impertinent for a British publication to ask the question in the week when Americans celebrate their independence from their former colonial masters. Most Americans spend the Fourth of July bowing the knee to beer and barbecue rather than George Washington and Thomas Jefferson. And besides, if any group of politicians deserves wholehearted admiration, it is surely the founders of the American republic, the authors of the soundest constitution that human ingenuity has yet devised.

Yet one of the wisest founders took the trouble to wag a warning finger against treating fallible men as faultless idols. John Adams was the second president of the country. But in his retirement he denounced the tendency to make demigods of men like Washington and Jefferson and, in true Puritan fashion, called for a second Reformation to wash away such idolatry.

Quite recently, it looked as if historians had taken his words a little too seriously. The fashion in academia was to focus solely on the Founders' clay feet. Jefferson was dismissed as a seducer of slaves who plagiarised chunks of the Declaration of Independence. Adams was a Yankee curmudgeon with a weakness for hereditary aristocracy. The founders were all dead white men who subverted the revolution's ideals to protect their economic interests. But suddenly historians are competing to restore them to their Olympian status, and the public is lapping it up.

Jefferson was dismissed as a seducer of slaves who plagarised chunks of the Declaration of Independence

De Tocqueville noted that democratic people have always had a weakness for memorialising their leaders. This weakness is particularly strong at a time when contemporary politicians are regarded as either bigots or panderers. Joseph Ellis's collective biography, "Founding Brothers" (Knopf), has spent 27 weeks on the *New York Times* best-seller list—and survived revelations that the author has lied about his own career. David McCullough's biography of John Adams (Simon & Schuster) has leapt to the number-one spot (and soaked up an extraordinary amount of press attention) in part because Adams satisfies the yearning for "authenticity". Now there is a movement to erect a no-doubt-authentic monument to Adams in Washington.

If these urges were confined purely to the founding generation, this would be a historical quirk. But it is not. The Ronald Reagan Legacy Project, the brainchild of Grover Norquist and his Americans for Tax Reform, is waging a relentless campaign to memorialise its hero. Getting the capital's National Airport renamed after him was only the start. It is now in the process of creating a Reagan memorial in each of the country's 3,067 counties (successes so far include a six-foot-tall portrait made entirely from 14,000 jelly beans). It wants his face to replace Alexander Hamilton's on the $10 bill, and to erect a Reagan monument on the National Mall, despite the Gipper's own belief that politicians should be dead for at least 25 years before being considered for the honour. Any day now the highway that leads up to Mount Rushmore will be graced with Reagan's name.

The left is not much better. Many Democrats continue to pretend that Jack Kennedy was a paragon of family values and Harvard-Yard liberalism rather than a womanising cold warrior. The keepers of the Kennedy flame threw a hissy fit a few months ago when the Republicans borrowed Kennedy's voice in an ad promoting the tax cut. They are also tireless in promoting his legend in everything from exhibitions to biographies.

By all means let us give the Reagans and Kennedys their due. But one of the problems with idolatry is that it gives them less than their due. Idolatry denies the human side of its subjects. Take the

philandering away from Kennedy or the hokiness away from Mr Reagan and you make them less interesting. Idolatry also reduces idols to nothing more than vehicles for their worshippers. The right's infatuation with Mr Reagan tells us more about its disappointment with his successors than it does about Mr Reagan. The left's embrace of Kennedy became much more firm when Bill Clinton turned out to be a disappointment.

The silliest example of idolatry's power to distort history can be found in the recasting of a great modern president, Franklin Roosevelt. Roosevelt was a patrician war leader who went to extraordinary lengths to conceal the fact that he was afflicted with polio. (Only two of the 40,000 photographs that were taken of him show him in a wheelchair.) But his admirers are rapidly transforming him into a PC prig who revelled in his status as a victim. A recent addition to the Roosevelt Memorial (FDR-PC to its critics) goes out of its way to depict the president in a wheelchair. His signature cigarette and cigarette-holder have been airbrushed out of history. The only reference to the war that defined his career is a single phrase: "I hate war."

Roosevelt's signature cigarette and cigarette-holder have been airbrushed out of history

At least the people who are trying to deify Mr Reagan and reinvent FDR are doing so out of misguided hero worship. Far worse are the politicians who deify themselves. Self-worship is hardly a new political vice. But, with the exception of Huey Long in Louisiana, politicians have usually had to wait for other people to erect the monuments (usually after their deaths). Not all, though. Senator Robert Byrd has some 30 things named after him in West Virginia. Bud Shuster, a Republican congressman, retired this year, having littered central Pennsylvania with eponymous monuments, including the Bud Shuster Highway and the nation's first federally funded bus-testing centre. In South Carolina, Senator Strom Thurmond has not merely a highway named after him, but also a lake and a dam. And so on.

This craze for memorialisation is not just excessive, as even the most minor politicians demand their tributes in masonry, asphalt or stone. It is downright unAmerican. You expect to find tinpot countries like North Korea and Cuba littered with monuments to local dictators. But you expect better from a country founded on the principle that the proper way to treat politicians is not to worship them but to curb their ambitions with checks and balances—and the power of ordinary people.

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Colombia's wars

Don't celebrate yet

Jul 5th 2001 | BOGOTA
From The Economist print edition

EPA

The FARC may have released more captives than expected, but it still has no intention of making peace. Nor do the paramilitaries

Get article background

THE Tolemaida air-force base, not far from Bogota, was the scene on Thursday June 28th of a maelstrom of jubilation and tears. Some 242 police and soldiers were reunited with their families after spending up to three years in primitive jungle pens as hostages of the Revolutionary Armed Forces of Colombia (FARC). Their release was part of an agreement signed on June 2nd by the FARC, Colombia's largest guerrilla group, and the government of President Andres Pastrana. The rebels have now released a total of 363 servicemen in exchange for 15 guerrillas held by the state.

The government greeted the prisoner exchange, the first tangible achievement in two and a half years of stumbling peace talks, as proof that it can strike accords with the FARC that mean something. Not only had the rebels backed down considerably from their original demand for a permanent law to govern prisoner exchanges—one guerrilla for every soldier or policeman—but they released many more than the 100 servicemen stipulated by the agreement. A humanitarian gesture, said the FARC, to show it means peace.

Maybe. But away from the high emotion at Tolemaida, not many people see this moment as a high point in the peace process; not least because the FARC is continuing, and even stepping up, its military campaign. The prisoner exchange was accompanied by a carefully managed show of strength by the FARC, with some 3,000 heavily armed rebels forming a "guard of honour" for the liberated servicemen. Having liberated so many captives, an estimated 1,000 to 1,500 rebels dedicated to guarding the prisoners are now free to fight, and that, according to Jorge Briceño, the FARC's military commander, is just what they intend to do.

In a speech to his hostages before their release, Mr Briceño gave warning that his troops were ready to take their struggle to the country's cities, largely spared so far. Questioned about the small number of rebels released under the humanitarian accord, he replied that if the FARC wanted its members out of jail, it would simply go and get them.

So it appears. On June 23rd FARC rebels held at La Picota jail in southern Bogota blew a hole in the

prison wall; 98 prisoners, including 19 guerrillas, escaped under covering fire from at least 100 other guerrillas outside. The day before, the FARC killed 30 soldiers in an attack on the Puerto Leguizamo military base in the southern jungle province of Putumayo. The casualties were the heaviest inflicted on the armed forces in recent years. This week the FARC's political spokesman, Raul Reyes, flatly rejected the latest suggestions for a constituent assembly to reform the country's constitution. The guerrillas, he repeated, want a direct role in government in return for peace.

The increasing unrest has already caused the postponement until next January of the Copa America, the world's third-biggest football tournament, which was due to begin in Colombia on July 11th. Business representatives are now asking the government not to wait beyond October for a ceasefire. The FARC's dominion over its "enclave"—a tract of southern plains and jungle the size of Switzerland, granted to them by Mr Pastrana at the start of the peace process—is due to expire then, and many do not want it extended.

Sharp talk is also coming from government officials. Camilo Gomez, the peace commissioner, was due to announce changes this week to his negotiating team, hoping by this to galvanise the talks with the FARC. But the country's patience is wearing thin. In the most recent poll, support for the peace process was at less than 20%. If all-out war erupted between the two sides, each of them would be much better prepared to fight than they were when the peace talks began.

To add to Mr Pastrana's problems, the National Liberation Army (ELN), the country's second guerrilla group, also said this week that it was pessimistic about the prospects of making peace with his government. Although this seemed the president's best chance of a peace deal before he leaves office next summer, negotiations have failed to get off the ground in the face of fierce opposition from the right-wing paramilitaries of the United Self-Defence Forces of Colombia (AUC). As a sign, it seems, of their determination to undermine any moves towards peace with the ELN, the paramilitaries have apparently switched the AUC's operational centre from the far north-east of Colombia to the Sur de Bolivar, where the ELN wants to hold its peace convention. The joy of Tolemaida seems premature indeed.

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Brazilian justice

The favoured few

Jul 5th 2001 | SAO PAULO
From The Economist print edition

Two cases show how much is wrong

TWO of Brazil's most notorious accused men will be able to await the slow progress of Brazilian justice in the comfort of their own homes. Early on June 30th, Ubiratan Guimaraes, a retired police colonel, was sentenced to 632 years in jail for ordering the massacre of 111 prisoners after a jail riot in 1992. He was immediately freed pending his appeal, which will take at least another year. A few hours earlier, Nicolau dos Santos, a retired judge accused of organising the embezzlement of almost 200m *reais* ($87m) from the construction of a court in Sao Paulo, was transferred from police custody to house arrest after another court had accepted his claim to be suffering from "grave depression".

Brazil's outdated court procedures and its profusion of poorly drafted laws offer ample opportunities to those with good lawyers to have trials delayed and verdicts reconsidered. In contrast, poor defendants without their own lawyers can spend ages in overcrowded police cells, waiting for their first court appearance. Armando Tambelli of the Catholic church's prison mission in Sao Paulo says some have spent two years awaiting trial.

Those unable to hire their own lawyers are supposed to be represented by public defenders. But these are so scarce that most prisoners see them only when their case eventually reaches court. Prisoners awaiting trial who are seriously ill can personally petition to be released into house arrest. But their request is unlikely to get far without a lawyer to pursue it.

Under Brazil's "law of heinous crimes", those found guilty of murder are supposed to be held in jail pending any appeal. But there is an exception for those—like Mr Guimaraes—accused of giving the order to shoot as opposed to pulling the trigger themselves. Even if his appeal fails, Mr Guimaraes will enjoy perhaps several more years of liberty because of another peculiarity of Brazilian law: those receiving a sentence of more than 20 years' jail, even if this is upheld on appeal, have an automatic right to be tried again.

This particular trial has already taken an outrageously long time. The massacre took place in October 1992 when police entered Carandiru jail in Sao Paulo after a riot there. Years passed while the civilian and military courts argued over who should hear which charges relating to the killings. Last year Brazil was condemned by the Inter-American Commission on Human Rights for its "failure to investigate, bring to trial, and punish seriously and effectively those responsible".

Reforms of the courts and the penal code have been talked about for years. In 1999, after seven years of redrafting, the lower house of Congress began debating a bill to speed up court proceedings by, among other things, guaranteeing a right to a speedy trial and abolishing some grounds for appeal. It was passed, but is still stuck in the Senate.

This March, faced with worsening overcrowding in cells, leading to riots and breakouts, the government sent Congress a proposal to reform the penal code. To cut the numbers of accused being held for long periods awaiting trial, it would set time limits on police investigations. And trials would be streamlined by reducing the number of separate hearings required. The aim is to cut the average length of a criminal proceeding from eight months to three. But the chances of reforming the criminal code do not look good: a proposed reform of the civil-law code has been stuck in Congress for 25 years.

A surfeit of legislation is another main impediment to the smooth functioning of the justice system. In March, after two years' study, a team of government lawyers concluded that Brazil had 27,471 laws. Many of these, poorly drafted or contradictory, are a gift to lawyers wishing to string out proceedings or have charges dropped. If only a few could be weeded out, justice might be better served.

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Cuba

None too sweet

Jul 5th 2001 | HAVANA
From The Economist print edition

Poor prospects for the sugar harvest

CUBA was built on sugar, and to a large extent it still is. The progress of the crop, the state of the fields, the readiness of workers and machines, are all minutely watched—and, where necessary, sharply criticised—by government officials in the state-run press. Already, this year's harvest looks as though it will leave a bitter taste. The minister for sugar, Ulises Rosales del Toro, has admitted that it will be less than 3.6m tonnes: below the 3.7m tonnes that were predicted, and a good 10% less than last year.

Truth to tell, the industry has been in decline for some time. Tourism and, much more recently, nickel mining have both overtaken it as earners of foreign currency. But sugar still dominates the Cuban landscape. The rusting hulks of huge refineries are scattered through the countryside and, at harvest time, thousands of cane-cutters toil in the fields under a blazing sun.

Large-scale sugar production began in Cuba at the beginning of the 19th century, when hundreds of thousands of slaves were brought from Africa to work the plantations. By the late 1880s, the island was the world's biggest sugar producer. The Americans took over much of the sugar industry at the beginning of the 20th century, but left when their plantations were expropriated and nationalised after Fidel Castro came to power in 1959.

Sugar continued to be Cuba's main industry. Mr Castro and his partner in revolution, Ernesto Che Guevara, tried to inspire the workers by picking up machetes and chopping cane themselves, sweating profusely. The sugar was used in exchange for goods from East European countries until the collapse of the Soviet block in 1989. The industry now produces half as much as it did in the 1960s.

The new minister, Mr Rosales, a military man with a reputation for getting the job done, was brought in to shake the sugar industry back into shape. Much was expected of him: unreasonably, since the state of the old Soviet machines and the refineries gets worse every year, and Cuba cannot afford to replace them. Of course, he has not delivered. "Next year we'll have to produce 4m tonnes or more," he says, setting the bar yet higher.

Only twice in the past 50 years, in 1995 and 1998, have sugar harvests been below 3.7m tonnes. The final figure for this year was due to be announced some weeks ago. Instead, the state-run newspaper, *Granma*, has carried stories of poor weather conditions and badly maintained machinery, as though to prepare the readers for the bad news to come. One recent headline simply read: "The Combine Harvesters are not Fulfilling their Potential".

Add to those reasons—excuses, some might say—the poor state of Cuba's roads, the constant shortage of petrol and the lack of economic incentives for those working in the sugar industry, and a clearer picture begins to emerge. Sugar workers are still paid in Cuban pesos, which go nowhere and buy little. Many, if they can, prefer to earn dollars in the tourist industry.

Mr Rosales sees some bright signs: less waste, cutters working harder. These improvements in work practices should continue. He professes to be convinced that the harvest will reach 6m tonnes in the near future. And although the quantity of this year's harvest is down, Mr Rosales says the quality is up, and the sugar is fetching higher prices on the world market.

Most of the big houses in west Havana, still grand despite years of tropical humidity and neglect, were built from the proceeds of the great days of Cuba's sugar industry. Although those days have gone, tourism and other industries have still not completely filled the gap—not least in the psychology of Cuba's rulers.

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Post-industrial Chile

Reviving Lota

Jul 5th 2001 | LOTA
From The Economist print edition

A town discovers life after coal

PERCHED on a cliff overlooking the Gulf of Arauco, the town of Lota (population 52,000) was once the thriving heart of southern Chile's state-owned coal-mining industry. The mine closed in 1997, defeated by production costs that were seven times the coal's market price. The closure stopped that loss, but opened the question of whether the government's transformation plan for Lota would prove as much of a bottomless pit as the mine itself.

The authorities started by improving access to the town. Nowadays, the 40- minute drive south from the regional capital, Concepcion, is along a modern dual carriageway, and modern telecoms services have replaced crank-handle telephones. Government money has also helped to bring out Lota's picturesque features. Traditional back-to-back miners' houses have been dolled-up with fresh paint and individual lavatories, and tourists can visit both the mine and an old hydroelectric power plant that is said to be the oldest in South America.

In many ways, Lota is lucky. The fighting spirit of the *lotinos*—one of the reasons, they claim, that General Augusto Pinochet did not close the mine during his dictatorship—has helped to ensure aid on a scale not often available to other towns in a similar predicament. But Lota's unemployment rate, at almost 20%, is still twice the national average.

Many former miners have a pension, but poverty is rife among families that depended indirectly on the coal industry. According to Luis Quiñones, the rector of the town's new technical training institute, almost two-thirds of the students come from families with an income per person of less than $66 a month, putting them below Chile's poverty line.

The miners resent pity, but feel entitled to aid. That is partly old habit. In its heyday, the state mining company, Empresa Nacional del Carbon (Enacar), supplied not only tied housing, but almost everything else. "When we wanted a light bulb changing, we called the Enacar repair service," one miner remembers.

In some ways, the miners are their own worst enemy. Accustomed to strong labour unions, they still see collective action, rather than private enterprise, as the means to ensure survival. The Communist Party is still strong in the town. Nonetheless, some Lota miners have found a new life. A few have successfully switched to working in a nearby naval shipyard. The former Enacar hospital will soon become a call centre, answering directory inquiries for Chile's main telephone company; that will create 160 jobs. The state bank, Banco del Estado, is also building its call centre in Lota.

Call centres, however, mostly employ young women. What are the men to do? The government plans to award a private concession for an industrial port, but there is spare capacity at other ports nearby. An industrial park got off to a bad start when some firms stayed only long enough to collect the subsidies.

As a result, government officials recognise that Lota's transformation is unlikely to help the miners themselves. They have set their hopes on the next generation. One project that is regarded as an

unqualified success is the technical training institute, run by the University of Concepcion. So far, 150 graduates have found jobs—though mostly in Concepcion and other nearby towns, rather than in Lota itself.

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Argentina

A worm turns

Jul 5th 2001 | BUENOS AIRES
From The Economist print edition

Carlos Menem booked by his friend

WHILE Carlos Menem was still president of Argentina, Jorge Urso, an investigating judge, supposedly referred to him as “my boss” and made regular pilgrimages to the presidential residence. To Mr Menem’s chagrin, the judge’s attentions have recently become far less friendly.

Reuters

Last month Mr Urso refused the ex-president permission to leave the country for his honeymoon, forcing him instead to spend it under house arrest. This week he formally charged him with heading a conspiracy to ship arms illegally to Croatia and Ecuador between 1991 and 1995. The former chief of the armed forces, Martin Balza; a former foreign minister, Guido Di Tella; and another ex-minister, Erman Gonzalez, were charged with helping.

Although Mr Menem’s reign was characterised by colourful corruption scandals, the case is the first to result in his detention (the first detention of an elected Argentine president in any period of democracy). It results from the new-found energy of Mr Urso, who, for years, had been criticised for his lethargy in investigating the case.

The judge has new incentives to demonstrate efficiency. His former political patrons, staunch Menem folk, have little power now to block investigations into Mr Urso’s remarkable recent increase in wealth. He is under pressure, too, from his superiors in the second federal court, famous for its resistance to political influences.

Mr Urso’s new-found gusto also suggests that the judiciary, packed with Mr Menem’s appointees and notoriously sympathetic to his promptings, has begun to discover its independence. All bad news for the former president.

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The Olympics

Five rings for Beijing?

Jul 5th 2001 | BEIJING
From The Economist print edition

The site of the 2008 Olympic Games will be announced in Moscow next week

JIANG ZEMIN must be a nervous man. On Friday July 13th, the International Olympic Committee (IOC) will vote on which of five competing cities will hold the 29th Olympic Games in 2008. Success for China's capital would generate nationwide euphoria and kudos for President Jiang. Failure—that is, yet another humiliation for Beijing, after its loss to Sydney in 1993—would result in sullen introspection and bitter recrimination. China's neighbours worry that a disappointed China could even turn belligerent.

AP

In a country whose politics places such great store by symbolism, Beijing's bid for the Olympics means a lot more to China's leaders than the rival bids by Paris, Toronto, Osaka and Istanbul do to those cities' national leaders. Ordinary Chinese also tend to see the IOC vote not just as a vote on Beijing's suitability to hold a big sporting event, but a vote on China itself. The award of the 2000 Olympics to Sydney fuelled a militant brand of Chinese nationalism. Many Chinese accused American legislators of having undermined Beijing's chances by adopting a resolution saying that China's human-rights record made it unworthy to hold the games.

The timing of the forthcoming IOC vote must be particularly unsettling for Mr Jiang. This is a period of great symbolic events at home and abroad that he would not want overshadowed by defeat. On July 1st the Communist Party celebrated its 80th birthday with a gathering of thousands at Beijing's Great Hall of the People. Mr Jiang used the occasion to try to present a new image of the party as a party for everyone, dropping a strong hint that even private entrepreneurs—"exploiters", as party conservatives still call them—will be allowed to join.

Then, just two days after the IOC convenes in Moscow to reach its verdict, Mr Jiang is due to begin a state visit to Russia. The highlight of this will be the signing of the first political treaty between China and Russia since the 1950s. Although it will contain little more than platitudes about friendship, co-operation and the world in general, it is clearly intended as a gesture of warning to the United States that the Russia-China axis is not to be underestimated.

Mr Jiang has a fair chance of glory. Beijing is tipped as a front-runner, though so are Paris and Toronto. IOC delegates may feel that it is time to award the games to a developing country. Not since Mexico city in 1968 have they been held in one, unless you count Seoul in 1988, the last time the summer games were held in Asia. Yet China will have to hope that its human-rights record does not wreck its chances. With particularly unhelpful timing this week, the Falun Gong sect alleged that the Chinese police had tortured to death 15 of its followers in a labour camp last month. Officials said they had attempted suicide and that three had succeeded.

Despite such obvious shortcomings, even some of China's critics, including the Dalai Lama and Taiwan's president, Chen Shui-bian, have offered some support for Beijing's bid. The commonly touted argument is that the Olympics might have the same effect on China as they supposedly had on South Korea, forcing the host government to ease political repression in order to prevent the games being tarnished by international opprobrium. There is some logic to this. Mikhail Gorbachev's visit to Beijing in May 1989, the first by a Soviet leader in 30 years, made Chinese leaders reluctant to suppress the Tiananmen

Square protests—until he had gone.

At least some of China's recent reluctance to confront Taiwan or the United States, despite what it regards as clear provocations, could also relate to its bid for the Olympics. And last week China allowed a North Korean family that had taken shelter in the United Nations refugee agency's office in Beijing to leave the country and make their way to South Korea, instead of repatriating them as it normally does.

Yet giving China the games can hardly be expected to ensure a consistent easing up over the next seven years. Indeed, China's growing concerns about social instability make it likely that repression will, if anything, intensify in some quarters. In the past few weeks, with Beijing's bid still under consideration, several newspaper editors have been dismissed or criticised for articles deemed damaging to the party's image. The probing and popular *Southern Weekend* in Guangzhou has been a particular target. An outspoken economist and social critic, He Qinglian, has fled to the United States, complaining of police harassment. Late last month police beat up an American photographer who had taken pictures of a man being detained outside the Forbidden City in Beijing, where Luciano Pavarotti, Placido Domingo and Jose Carreras were giving a concert in support of the Olympic ideal.

American government has kept out of the debate, though the State Department issued an excoriating critique of Chinese human-rights abuses earlier in the year. This week the last remaining parts of an American surveillance plane that made an emergency landing in China in April were flown out of the country on a Russian-made aircraft. American officials do not want to provoke renewed tension by attacking Beijing's bid. As for Congress, Ralph Cossa, at the Centre for Strategic and International Studies in Honolulu, argues for restraint there, to avoid feeding anti-American sentiment in China and playing into the hands of hardliners. And happily for Chinese-American relations, the mood in Congress is indeed noticeably less militant than in 1993. Despite the best efforts of a few sticklers for human rights, no resolution against the Beijing games has made it through the House or Senate. But there is still a week to go.

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Chinese verse

Random thoughts

Jul 5th 2001 | BEIJING
From The Economist print edition

President Jiang turns poet

NOT since the days of Chairman Mao has the poetry of a living Chinese leader been part of China's school curriculum. But President Jiang Zemin has written a poem that has so captivated the hearts of Shanghai's bureaucrats that it is being written into textbooks. According to the *Shanghai Express,* the aim is to "arouse the patriotic ardour of students and their respect for great men".

The poem in question took the nation by storm on May 29th, when the *People's Daily* splashed it on the front page under the banner headline, "A Poem by Jiang Zemin". Consisting of four lines of seven characters each, it describes the 74-year-old's "random thoughts on climbing Huangshan", a mountain in Anhui province that has inspired many a poet and emperor before him. "Holding a dreamy pen to record the spectacular scene, as sun broke through the waves of clouds, turning them red for ten thousand miles...," it gushes.

The Shanghai University Publishing House saw an opportunity not to be missed. In time for the start of the new school year in September, it is revising a primary-school textbook to include Mr Jiang's poem, and plans to include it in a second one, of classical Chinese poetry set to music. One of the editors, Zhu Xianquan, says the books will be used by 30,000 Shanghai children.

A music teacher in Shanghai, Jiao Feng, is responsible for the musical version. Mr Feng was reportedly so excited by the appearance of Mr Jiang's poem (his third published this year) that he composed a tune to go with it and tried it out on a class of six-year-olds. "Within a mere 40 minutes, the children were not only able to recite the poem by heart, they could even paint pictures of the scenery described by Mr Jiang," said the *Shanghai Express*.

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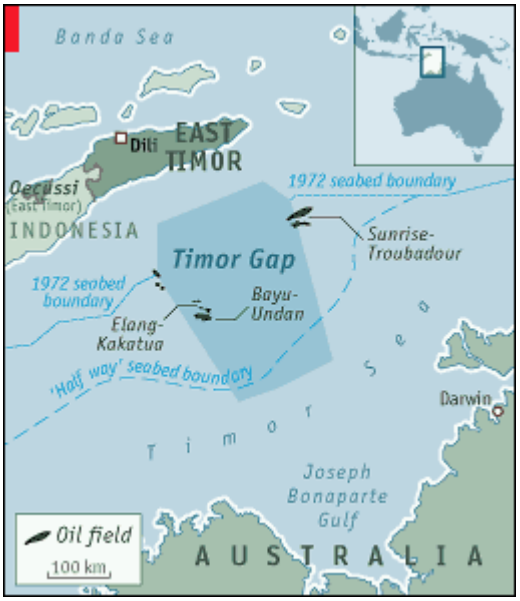
The Timor Gap

Australia sees reason

Jul 5th 2001 | BANGKOK
From The Economist print edition

Asia's newest almost-country has gained the rights to a precious asset

GOOD news has been rare in East Timor, but there was a big dollop this week. On July 3rd it cut a deal with neighbouring Australia to share the vast oil and gas reserves in the sea between the two. A previous treaty, widely seen as unfair, had divided the resources equally between Australia and Indonesia, from which East Timor—once a Portuguese colony, then invaded by Indonesia—gained its independence after a referendum two years ago. Under the new deal, East Timor will receive 90% of the revenues. As it prepares for its second anniversary, and its first free elections, on August 30th, it surely needs all the help it can get.



If they are not squandered, the energy revenues can clearly give the economy a boost. In the two decades after 2004, the fields are expected to bring in $180m a year for East Timor, roughly three times its current budget under the United Nations' administration. Put another way, the projected annual revenues amount to $225 per person, compared with current GDP per head of only $250.

The deal will also make life easier for Australian diplomats. After decades of snuggling up to former President Suharto—the generous terms given to Australia over the Timor Gap being a reward for its acceptance of Indonesia's 1975 invasion—Australia stuck its neck out for East Timor after the August 1999 referendum. It agreed to lead an international military force into the territory after Indonesian-backed militias went on a killing spree and razed many East Timorese towns. Australia's support for East Timor still enrages many Indonesians. But when the time came to discuss the energy reserves, Australia quickly developed a reputation for meanness towards the newcomer, at first offering East Timor only 60% of the revenues, and later 85%.

Australia has dawdled partly to avoid setting a bad precedent over its new border with Indonesia. This week's deal skirts that issue by continuing to treat the fields as a single shared entity, without for the moment fixing the boundary between Australia and East Timor.

It also lets Australia go back to grappling with its more pressing diplomatic worries. Despite a recent visit by Indonesia's president, Abdurrahman Wahid, it will be hard to win over his nationalist vice-president, Megawati Sukarnoputri, who will almost certainly replace Mr Wahid next month. Malaysia's prime minister, Mahathir Mohamad, continues to hurl abuse as well, lacing a speech last month with a nasty imitation of an Australian accent. As a rich country with respect for democracy and human rights, Australia can wear criticism from such neighbours with pride. But picking on a poor, small, defenceless young democracy by trying to steal its oil money...well, that is another matter. There will be smiles all round now that Australia has put this one to rest.

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Indian politics

Arresting times

Jul 5th 2001 | DELHI
From The Economist print edition

An unorthodox route to power

ONLY in India, perhaps, is an arrest on criminal charges a passport to political power. On June 30th, in the southern state of Tamil Nadu, the former chief minister, Muthuvel Karunanidhi, was arrested in the middle of the night on suspicion of receiving kickbacks from contractors building flyovers in the state capital, Chennai. He resisted, saying he was the victim of a political vendetta.

Reuters

Karunanidhi the hero

Two ministers of the central government in Delhi who belong to Mr Karunanidhi's regional party, DMK, protested at his arrest, and were also arrested after a scuffle. The arrested politicians feigned dismay and outrage, but in fact they were delighted. In the state election last May, a rival regional party, headed by Jayaram Jayalalitha, had thrashed them. They believed they could convert their arrest into a sob-story of mistreatment and vendetta at the hands of Miss Jayalalitha, thereby sparking a wave of public sympathy and enabling them to win the next election.

That, after all, is how Miss Jayalalitha returned to power in May. She was chief minister in 1991-96, and was beaten in the 1996 state election after allegations of corruption (exemplified by her collection of shoes, larger even than that of Imelda Marcos). Mr Karunanidhi instituted a special court to try her on a number of corruption charges, hoping this would end her political career. Meanwhile, she was held in jail. But the lady fought back by saying she was a victim of a feud. She was convicted in one case but has appealed, claiming the judges were politically biased. The really corrupt crowd, she insisted, was the one around Mr Karunanidhi.

In most other countries, the main issue would be whether the charges were true. But not in India, where cases rarely reach the final court of appeal, and so charges are rarely definitively proved. The main debate has been about whether a 78-year-old man should have been arrested in the middle of the night, and whether excessive force was used by the police. Television stations constantly replayed shots of Mr Karunanidhi crying out in pain and anger, and of one of his colleagues being reduced to his underwear in the scuffle. Realising that she was losing the television war, Miss Jayalalitha ordered the release of the two Delhi-based ministers on bail. But they refused to seek it. The charges against them were then withdrawn. Mr Karunanidhi has also refused to seek bail; being in jail provides ever more photo-opportunities. But he too has now been released, though he may still be prosecuted.

Miss Jayalalitha has lost this media battle, perhaps because several reporters also were arrested. Arresting politicians is one thing; arresting journalists is another, even if they are partisan. Miss Jayalalitha erred by ignoring this principle.

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Japan and global warming

A bit foggy

Jul 5th 2001 | TOKYO
From The Economist print edition

Confusion over the Kyoto treaty

NOT without America, Junichiro Koizumi told his friends in Washington at the weekend. Together with Europe, he said in Britain on Monday. On July 4th, with Japan's prime minister now in Paris, his country's stance on whether it would ratify the Kyoto Protocol, a UN treaty on global warming, had become as uncertain as the solution to the phenomenon itself.

AP

Green Japan

Japan's discomfort is about to get worse. Not only is the government caught between warring Europeans and Americans, its own house is divided too. Although George Bush has made it clear that America will not ratify Kyoto after the next round of climate talks, which begin in Bonn on July 16th, the Europeans say they want to press ahead anyway, hoping to shame America into joining later. For the treaty to take effect, however, one condition is that Kyoto must be ratified by countries accounting together for at least 55% of industrialised countries' greenhouse gas. With Japan, the Europeans clear the hurdle. Without Japan, they do not.

The Japanese cannot hide behind their ambiguities for much longer. On July 9th Margot Wallstrom, the European Union's environmental commissioner, will be in Tokyo to press the government for a straight answer. The Japanese will find that hard to provide. The environment ministry wants to ratify Kyoto as quickly as possible. The economy, trade and industry ministry, or METI, is less enthusiastic. From the start, METI has argued that Japan got a bad deal out of Kyoto. Kyoto sets the base year, against which countries' efforts to reduce greenhouse-gas emissions are measured, as 1990. By that time Japanese companies, responding to the second oil shock, had worked furiously to cut energy consumption and the most straightforward ways of reducing greenhouse gases had already been exhausted.

METI sets great store by a voluntary emissions-curbing scheme organised by the Keidanren, a big-business lobby. However, there are plenty of Japanese industries that stand to benefit from Kyoto. Japan's car companies, for instance, are world leaders in green technologies. And "Kyoto" is not set in stone. METI is ready to live with it, given the use of "flexible" rules in meeting emissions targets. If Japan were allowed to make full use of this flexibility, by offsetting credits for its forests (which absorb carbon dioxide) against debits for its polluters, its present obligation—to reduce emissions to 6% below 1990 levels in a decade's time—would be cut in half.

European purists have in the past heaped abuse on this flexibility, arguing that it is a roundabout way for countries to do nothing. Recently, however, Europe has become less unbending. Mrs Wallstrom is likely to offer the Japanese almost everything that METI wants. Whether that will be enough may in the end depend on the foreign ministry. Its pro-American faction—almost slavishly pro-American, in some eyes—hates the thought of siding with the Europeans against Mr Bush. Yet Japanese public sentiment has this week been inflamed by the United States' slowness in handing over an American airman suspected of yet another rape in Okinawa, where it has a military base. The battle, it seems, is on.

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The Philippines

Sorting out the south

Jul 5th 2001 | ZAMBOANGA
From The Economist print edition

Besides battling kidnapping gangs from Mindanao, Gloria Macapagal Arroyo must also make up for past neglect of the region

HER macho predecessor delivered his lines slowly, with his head tilted forward like a true Filipino action hero. Gloria Macapagal Arroyo, in contrast, speaks with a high-pitched whine, and must sit up straight to make the most of her tiny frame. But in her dealings with kidnappers from the Abu Sayyaf group, Mrs Arroyo has been at least as tough as Joseph Estrada. Vowing to "crush" them, she has unleashed her troops rather than negotiate dangling offers of ransom, despite the obvious danger to the hostages.

So far, this approach has yielded only minor rewards. On July 3rd the Abu Sayyaf—an assortment of entrepreneurial kidnappers under an Islamic brand name—released two hostages on the south-western island of Basilan. Some Abu Sayyaf members have been killed in skirmishes with the government. The armed forces, however, are still searching for about 20 other hostages, including three Americans, who were taken from a beach resort on Palawan in May. The kidnappers, who collected hefty ransoms while Mr Estrada was in power, have bought faster speedboats with some of the money and are hard to track in the jungle-covered islands of the Sulu archipelago.

Yet while the war on the Abu Sayyaf continues, Mrs Arroyo's government is quietly seeking deals with other Muslim groups, armed and otherwise, in Mindanao. The most notable of these is the Moro Islamic Liberation Front (MILF), a separatist group that Mr Estrada tried to exterminate, but which in June signed a ceasefire agreement with Mrs Arroyo's government. She is also trying to improve relations with the Moro National Liberation Front (MNLF), which accepted a peace deal under the government of Fidel Ramos, Mr Estrada's predecessor. Although a failure to tame the Abu Sayyaf would hurt Mrs Arroyo's popularity, these other efforts to improve life in Mindanao are in many ways more important—both for the Philippines' development and for her own future as president.

Economics alone makes Mindanao crucial. It has the Philippines' best farmland and receives steady rainfall throughout the year, instead of the seasonal typhoons that plague the central and northern islands. Its crops range from bananas and pineapples to coffee, maize and livestock; some 40% of the country's food is produced here by 20% of its population. A few investments in stable areas have already shown the potential. The southern town of General Santos has reaped rewards from a new port for tuna boats, and has paved its roads to attract other businesses. If Mrs Arroyo can bring stability to other parts of the island, and help its disparate groups to run things better, Mindanao could attract much more aid and investment, and do more with it.

Politically too Mrs Arroyo will pay a price if she fails to deliver peace and development. Although the Philippines' Muslims are concentrated in Mindanao, the region is fairly evenly divided between Muslims and Christians. Mr Estrada's all-out war on the MILF further polarised these groups. In the congressional elections in May, Muslims voted heavily against candidates backed by Mr Estrada, while many Christians continued to support him, partly because they approved of his military campaigns. The risk is that Mrs Arroyo will fail to meet the Muslims' expectations, while continuing to lose support from Christians who think she is too soft on the separatists.

To win over sceptics, Mrs Arroyo has tried to persuade both groups in Mindanao that she takes the region seriously. She has several people from Mindanao in her government, including Teofisto Guingona, her

vice-president, and has reminded people that she lived in the northern Mindanao town of Iligan as a girl.

Her negotiators believe that the MILF talks, which will continue in Kuala Lumpur later this month, are going well. They are especially pleased about one provision that has gained little notice: an agreement to give the government access to development projects in MILF areas. A negotiator says that, since most MILF supporters are neither fervent separatists nor diehard Islamists, economic growth is all the government needs to win them over.

In contrast, the one outfit to sign a true peace deal, the MNLF, could yet prove the most troublesome. Both sides have failed to keep the commitments they made in the deal signed under Mr Ramos: Mr Estrada showed little interest, and the MNLF's top figure, Nur Misuari, seemed happier as a rebel than as an administrator. Mr Misuari recently had to cede some power to the MNLF's disaffected central committee. In an election set for November, he will probably also lose his job as head of an autonomous Muslim area made up of four of Mindanao's provinces. Mrs Arroyo must find a way to work with the MNLF's widening leadership, and prove that peace really can bring prosperity.

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The Millennium Action Plan

Africa's plan to save itself

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African leaders are promising reform, and asking the rest of the world to help

TRYING to construct a set of goals and policies for Africa that both George Bush and Robert Mugabe would sign up to is nearly impossible. But this week a team of drafters was closeted in a hotel in South Africa, attempting to incorporate some last-minute comments from African governments in order to make the Millennium Action Plan (MAP) for African recovery acceptable to as many African leaders as possible. But if the plan looks like an African begging-bowl held out to the rest of the world, it will be ignored.

The plan is the brainchild of Thabo Mbeki, who wanted a way of bringing to life his vision of an "African renaissance". Working with the presidents of Nigeria and Algeria, Olusegun Obasanjo and Abdelaziz Bouteflika, South Africa's president set up a team to write a plan that would inspire Africa to create a better future for itself—and persuade others to take it seriously. The hope is that if African leaders commit themselves to democracy and human rights, to tackle disease and reform their economies, and generally to get their act together, the rest of the world will start investing in Africa again.

The mood of the UN millennium summit last year suggested that the world might be ready to help. Later, Tony Blair let it be known that he wanted some big scheme for Africa to feature in his second term as Britain's prime minister, but that he also wanted the initiative for this scheme to come from Africa, and that he would then respond.

This is what is happening. The MAP, an African initiative, is to be presented to heads of government at an Organisation of African Unity (OAU) meeting in Lusaka next week. After a bit more fiddling with the text, the OAU is expected to endorse the plan, and individual African rulers will sign up to it. Mr Mbeki will then, with the help of Mr Blair, present the plan to the G8 summit in Genoa the following week.

The plan's central thesis is that Africa's development depends on its full involvement in the global economy, and that this requires a mixture of reform in Africa and assistance from other countries. The most important reforms are:

• establishing peace, and more democratic government;

• respecting human rights;

• investing in people by giving them better health and education;

• diversifying economies, and encouraging trade both within Africa and with the outside world;

• combating disease and boosting new technologies.

In return, the plan asks the developed world for more debt relief, the removal of trade barriers and the ending of its farm subsidies. Aid is low on the agenda, being mentioned only in the last few pages.

Plans and promises of reform in Africa have been two a penny in recent years; getting them implemented is the hard bit. The MAP puts its faith in peer pressure, and monitoring performance with timetables and targets. Not unnaturally, African leaders want matching commitments from donors, demanding that help should be open, clearly aimed and co-ordinated.

The plan's hopes and ideas are not new but, so far, they have been propounded by donor countries. The MAP appears to be Africa's acceptance that the donors were roughly right, and that their conditions for aid were not so much neo-colonial bullying as the rules of a globalised economy. But not all African leaders will go that far. Some Africans—not Mr Mbeki—strongly believe that it is their right to claim aid from the developed world in compensation for past exploitation.

The plan's delicately balanced structure remains shaky. At a meeting in Cairo last week, African ministers tried to hook several of their own pet ideas on to it. Senegal's president, Abdoulaye Wade, has drawn up his own plan, which is basically a call for more aid, and wants it incorporated. The Nigerians have begun to talk about debt relief for middle-income countries, such as themselves. But this is something that no donor country will look at.

The drafters in Pretoria, surrounded by African ministers and ambassadors, know that some leaders, above all Mr Mugabe, will still insist on blaming the past or "neo-colonialism" for their ills, and will certainly not approve a document that wants dictators isolated or property rights respected. The battle is for the middle ground. The difficulty is to find a formula that enough Africans can accept but that will still convince world leaders that Africa is serious about reform.

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Ethnic violence in Nigeria

Village against village

Jul 5th 2001 | TUDUN ABADU
From The Economist print edition

Fighting over the rights of "settlers" leaves scores of people dead

IN THE early hours of June 26th, a gang of young "warriors" of the Tiv ethnic group crept into the village of Tudun Abadu, in central Nigeria, armed with ageing guns, machetes, spears, and bows and arrows. Firing their guns in the air, they broke into the house of the local chief, led him out into the open and beheaded him. As the village awoke in panic, the young killers, some of whom were recognised as pupils in the nearby school, started hunting down other prominent people. In one house, five people, including two children, were killed; their blood is now splattered across the walls. Survivors say that 58 people died in the massacre. Abdullahi Adamu, the governor of Nassarawa state, confirms 27 deaths.

The flight of the settlers

This particular cycle of violence started with the killing of a local traditional ruler on June 12th. Since then, probably more than 200 people, most of them Tiv, have lost their lives. According to the Nigerian Red Cross, 50,000 people have been displaced from their homes.

At the root of the fighting in Nassarawa is a struggle between those who consider themselves indigenous to the area and the people they look upon as "settlers". As a local leader in Deddere, the next village to Tudun Abadu, puts it: "We are all fed up with the Tiv." When he was growing up, no Tiv lived in his village. "Now they say they own it," he complains.

Some linguists, and Tiv tradition, say this ethnic group came originally from the east African highlands. Others say the Tiv come from what is now Congo. One senior Nigerian, who comes from central Nigeria, claims the Tiv are refugees from the Zulu wars of southern Africa. Whatever their origin, they have now lived in Nigeria for many generations. Yet, as pressure for land grows in this populous country, the tensions between people of different ethnic origin look like intensifying.

Mr Adamu, in Nassarawa, hopes that things will quieten down, but he says people need to be persuaded to stop thinking in terms of who is indigenous and who is a "settler". Just as important, those who are responsible for the killings that fuel the conflict have to be punished.

Since Nassarawa does not have enough police to contain the violence, Mr Adamu has held talks with his counterpart in neighbouring Benue state, to where most of the displaced Tiv have fled, and has set up a commission of inquiry.

Nigeria is plagued with religious as well as ethnic conflict. Reports from Bauchi state in the north of country tell of hundreds killed, and thousands displaced, after Christians rebelled against the imposition of Islamic law in Tafawa-Balewa. But this, so far, is unconfirmed.

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Sanctions on Iraq

Smart exit

Jul 5th 2001 | CAIRO
From The Economist print edition

The end of the smart sanctions

Get article background

FOR once, Saddam Hussein can justly declare victory. His mortal foes, America and Britain, had been plotting to tighten the 11-year siege of his regime by making United Nations sanctions “smarter”. But the threat of a Russian veto at the Security Council scuppered months of inter-continental haggling. This week, the old “dumb” sanctions were extended unchanged. The smart ones may now be sunk for good.

AP

Hands up for dumb sanctions

Iraq would, of course, prefer to see the sanctions lifted altogether. Mr Hussein’s hapless people remain stuck with the UN’s four-year-old oil-for-food programme (which allows Iraq to buy “humanitarian” goods with its oil money) as their only source of sustenance—plus a good bit extra, growing all the time, from government-controlled smuggling. This is not just depressing in economic terms, but morale-destroying to any Iraqi with dreams for the future. Even as his enemies were being forced into retreat, Mr Hussein’s victory was tarnished by reports of two of his senior envoys to the UN asking for asylum.

The turn of events also leaves Iraq with an ever heavier debt to Russia (it already owes it something like $8 billion, mainly for ancient arms deals). Iraq has long been wooing the Russians with promises of lucrative contracts and concessions in its oilfields. Now, as voting on smart sanctions neared, Iraq’s pledge soared close to $21 billion-worth of business, or so the Baghdad rumour-mill suggested. Whether or not that is anywhere near the truth, Russia will not have sold its veto cheap.

More happily for Iraq’s rulers, the prolonging of the current system preserves the breaches they have systematically poked through the sanctions wall. The growing gaps sustain a thriving underground trade which, together with kickbacks and surcharges on some legal contracts, is by now thought to be worth about $3 billion a year. This is still far less than the $18 billion that Iraq earned last year from its legal oil sales. But the underground income goes straight to the Iraqi regime to spend as it will (not necessarily on the needs of ordinary Iraqis), unlike the legal money that goes into a UN-controlled escrow account and has nearly a third lopped off for war-restitution and the UN’s not inconsiderable expenses.

The smuggling income, which smart sanctions were designed to cut off, gives Mr Hussein plenty of leeway to influence people. In particular, three of Iraq’s neighbours—Turkey, Syria and Jordan—have grown dependent on its cheap oil and hungry market. Small wonder that all three voiced strong doubts over the American-British plans. Through a recently reopened pipeline, Syria is believed to be importing up to $1 billion-worth of Iraqi oil a year at a huge discount. And in Jordan, a country that relies on Iraq for all its energy needs and a third of its exports, a recent opinion poll found 83% of respondents against

taking part in smart sanctions.

Britain and America had hoped to counter such hostility by protesting that smart sanctions would both relieve the suffering of the Iraqi people and encompass mechanisms to compensate their neighbours. A main purpose of the new scheme—apart from the wish to plug the holes in dumb sanctions—was to shift the blame for Iraqi suffering away from the UN and to the Iraqi regime itself. In the words of Sir Jeremy Greenstock, Britain's envoy at the UN, "There will be no reason why Iraq cannot import a full range of civilian goods, and Iraq will have no pretext to blame the UN for the suffering of the Iraqi people. The new proposals will nail that false charge once and for all."

This public-relations exercise collapsed. Instead, a long argument developed on which civilian or dual-use goods would be subject to review by a UN monitoring committee. The bickering over details became so prolonged and intense that the principle of the new sanctions, once apparently accepted by all the veto-wielding members of the Security Council, was again questioned by Russia.

At an open council debate on the issue, Britain and America appeared isolated. Even France, which, after a falling-out of sorts with Iraq, has been backing smart sanctions, wondered how Britain could want to keep a ban on foreign investment while also claiming it wanted oil-for-food to turn into oil-for-development. The convoluted wording of the new proposal was seen to be veiling stringent and intrusive controls on trade and finance, keeping Iraq a soup kitchen, albeit a more efficient one. Delegates from neutral countries, such as India and Malaysia, bluntly called for sanctions to be lifted rather than rejigged.

This was also the gist of a short counter-resolution tabled by Russia which returned to the first principles of the 1991 UN ceasefire resolution by saying that civilian sanctions should be dropped once the UN arms inspectors had reported that "a reinforced system of ongoing monitoring and verification in Iraq is fully deployed". But that hope remains remote so long as Iraq refuses all weapons inspections.

Russia was no doubt acting largely out of self-interest. Even so, its determination not only to stop smart sanctions, but to steal the terms of debate, captured the general mood. Most of the world, by now, is more weary of the siege of Iraq than wary of what they assume, rightly or wrongly, to be a much diminished enemy.

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Israel and the Palestinians

No quiet, no peace

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The ceasefire that isn't

COLIN POWELL'S success in holding Israel and the Palestinians to a ceasefire lasted about as long as the secretary of state's return flight to Washington on June 30th. The two sides had apparently agreed to seven days of "quiet" to precede the cooling-off period prescribed in the ceasefire brokered by George Tenet, the CIA chief. During the cooling-off, Israel would ease its military siege of the occupied territories and the Palestinian Authority would resume security co-operation. But first there have to be those seven days.

The Palestinians thought that they had secured a commitment from Mr Powell that the seven days would start from the moment he left town. They were swiftly disabused. The Israeli government, said Mr Powell, would "make a judgment as to whether or not it is quiet and by what definition." And Ariel Sharon is in no hurry to make this judgment. By quiet, he means "complete, utter quiet, with not a shot fired or a stone thrown."

Reuters

A funeral watcher

Israel's prime minister also means that the quiet should be on the Palestinian side, only. Israel itself has been quite active. On July 1st the Israeli army shot dead two members of the Islamic Hamas movement in what Israel said was a gun-battle, and the Palestinians said was an ambush. In a rocket attack from helicopter gunships, the Israelis then killed three men from Islamic Jihad near the West Bank town of Jenin. All five were planning bomb blasts in Israel, said the army.

The Palestinian response was predictable. On July 2nd, for the first time in a month, car-bombs rocked a town inside Israel. And so it went on. An Israeli was shot dead in an Israeli market town that straddles the border with the West Bank, a settler was found dead in a stream near Hebron and a third Israeli was killed near the border. The Israeli army killed a Palestinian, allegedly for planting explosives on a settler road near Nablus (it turned out he was a taxi driver planting the groceries of one of his passengers). And, after the killing of the Hebron settler, soldiers blasted the cave dwellings and water wells of Bedouins who live in the Hebron Hills. According to a human-rights organisation, 500 people were left homeless as a result.

Yasser Arafat railed against these actions as "flagrant violations" of Mr Tenet's ceasefire. But Mr Sharon has made it clear that the ceasefire will not begin until his definition of "quiet" has been observed, and the cabinet agreed on July 4th that Israel's policy of political assassination will not only continue but be broadened.

Mr Arafat still looks to western intervention; but his people are turning elsewhere. On July 2nd the National and Islamic Forces—a body that includes not only Hamas and Islamic Jihad but also Mr Arafat's Fatah—accused Mr Powell of showing "complete bias" to Israel over the ceasefire. It urged the "Arab and Islamic world" to prove that such partisanship will not serve American interests in the region. "We need to send the *intifada* across our immediate borders," said Hani al-Hassan, a veteran Fatah leader in Gaza.

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Belgium

A worrying European paradox

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Reuters

Under Guy Verhofstadt (above), Belgium took over the presidency of the EU this week. Are its own politics a splendid example to the EU—or an awful warning?

IT CAN sometimes seem as if the politics of Belgium have been organised as an ironic commentary on the affairs of the European Union. The EU is committed to the idea of an "ever-closer union" among the peoples of Europe; indeed its anthem, borrowed from Beethoven and Schiller, proclaims that all men will be brothers. Yet it has its headquarters in a country whose two main communities, the Dutch-speaking Flemings and the French-speaking Walloons, are growing, not at all fraternally, ever farther apart.

The two themes—European unity and Belgian disunity—have been closely related over the past six months as the Belgian government, led by Guy Verhofstadt, a Flemish liberal, struggled to secure cross-community acceptance of the latest reorganisation of the Belgian state. He made little secret of the fact that he was desperate to secure agreement before Belgium took over the EU's agenda-setting presidency in July. His country could not concentrate on his task of furthering Europe's ever-closer union, he implied, unless it had sealed the latest chapter in the slow divorce between its two linguistic communities. In the early hours of June 29th, Mr Verhofstadt at last got his deal, leaving him free to turn his attention to "Europe" and the start of the Belgian presidency. But what about Belgium?

Like several other reorganisations before it, the new Lambermont accord—named after the prime minister's residence—gives a bit more autonomy to Belgium's regions, a major demand of the Flemings, while placating the Walloons with extra funds from the centre for the French-language education system.

Nowadays almost everything that can be devolved to the regions has been. There is no longer a Belgian tourist office—just one each for Flanders, Wallonia and Brussels. By the end of the year there will no longer be a federal agriculture ministry either. Little more than social security and most tax issues still tie the Flemish and Walloon regions together. Few doubt that if and when there is another round of constitutional haggling, the Flemings will demand yet more fiscal autonomy for themselves and fewer subsidies for Wallonia.

Economic disparities between the two regions account for much of the bad feeling. Flanders is booming, while Wallonia is stagnant. Unemployment is low in Flemish towns like Antwerp and Ghent, but in Walloon towns like Charleroi and Mons, both still reeling from the slow collapse of mining and steel, about a third of the workforce is jobless. The political culture of Flanders is pro-business and centre-right, while in Wallonia the trade unions and socialists are strong, and entrepreneurs much thinner on the ground. One Flemish commentator likens Belgium to "a union between Bavaria and Sicily". The knowledge that Flemish taxes are supporting the unemployed of Wallonia is a recipe for resentment.

History speaks

But there is far more than economics behind the Flemish-Walloon row. The Flemings' antipathy to their French-speaking compatriots is fed by the fact that for most of Belgium's history the boot was on the other foot. Though Belgium was founded in 1830, it was not until 1889 that the first speech in Dutch was made in the national parliament. In the first world war, the story goes that Flemish infantrymen died because they could not understand orders from their French-speaking officers. The first Dutch-language university got going only in the 1930s, and the student revolt of 1968 in Belgium took the form of rebelling against the use of French as a language of instruction at the leading university, Leuven—widely known as Louvain.

To the outsider it would seem as if the whip-hand is now definitely with the Flemings. The Belgian population is split roughly 60:40 in favour of Dutch-speakers. No Walloon has been prime minister since the 1970s. Yet, though the Flemings are richer and more numerous, history means that they often maintain the outlook of the embattled underdog. As Derk Jan Eppink, a Dutch journalist who writes on Belgian politics, remarks: "In Belgium the majority has a minority mentality—and the minority thinks like a majority."

To this day language continues to embitter relations between the two groups. The French-speakers complain about the growing number of Flemish communities that refuse to do official business in any language other than Dutch. Their militancy can be extraordinarily petty. In one Flemish district, a school bus from a local French school has been refused permission to stop, because it has French writing on the side. But Flemings claim that they have been driven to this sort of rigour by the blithe Walloon assumption that Flemings will always be able to speak French. Indeed, they saw it as quite a breakthrough when Didier Reynders, the country's finance minister, said that he was going to take lessons to improve his Dutch.

The Blokhead factor

Perhaps it is the Flemings' minority mentality that accounts for one of the oddest and most disquieting features of Belgian politics: the strength of the far right in prosperous Flanders. The Vlaams Blok, a militant Flemish party that campaigns against immigration and for the break-up of the Belgian state, has been gaining ground steadily for a decade. Despite—or perhaps because of—its ostracism by all the mainstream Belgian parties, its share of the vote continues to go up relentlessly. In Flanders as a whole, opinion polls put the Blok above 15%, and in Antwerp, the country's second city, at the most recent local elections it won one-third.

Many Walloons have a ready explanation for the rise of a party regularly described as "fascist" in the French-language press. Flemish nationalism, they argue, is an intrinsically nasty right-wing ideology that embraced Hitler's Nazis enthusiastically; the Vlaams Blok is just its most extreme expression. This argument was boosted recently when Johan Sauwens, a member of the more moderate Flemish-nationalist Volksunie party, had to resign from the Flanders government after it was discovered that he had attended a reunion organised by Belgian SS veterans, replete with uniforms and songs.

The Blok's roots do indeed lie in the resentments of families of former Nazi collaborators who faced penalties and discrimination long after the war of 1939-45. But by dismissing the Blok as little more than a bunch of Nazis the Belgian political establishment has talked itself into a corner. Co-operation with such a force is inconceivable. But ostracism means that building governing coalitions is becoming ever harder, while confirming the Blok in its ways, and in its criticism of the political establishment as a cosy, self-serving and corrupt monopoly.

And that strikes a chord among many non-Blok Belgians. For Belgium has a habit of throwing up scandals that foster dark conspiracy theories about a self-protecting establishment. Witness the paedophile ring run by Marc Dutroux, which the police were astonishingly slow to detect, or the still unsolved murder of André Cools, a prominent French-speaking socialist, and other unsolved acts of violence.

Why a velvet divorce wouldn’t work

The EU’s Eurobarometer poll suggests that Belgians have less national pride than any other EU citizens except Germans. Many Flemings, citing Czechoslovakia as a civilised example, say that Belgium is bound eventually to break up. Asked what holds it together, Belgians often cite the royal family, the occasional sporting success, and Brussels. Yet the geographical situation of the capital city, 80% of whose people speak French, though it lies well inside Flanders, would make a Belgian version of the “velvet divorce” between Czechs and Slovaks all but impossible.

So the Belgians will probably stumble along together. Their eternal quest for devolution seems to mean that ever more layers of government have to be added. For a country of only 10m people, Belgium already has a startling number of parliaments: one for the country as a whole, one for Brussels, one for Wallonia, one for Flanders, one for the tiny German-speaking community, and one for French-speakers (wherever they may be). Brussels even has a farm minister, though it has only one identifiable farm.

With the Lambermont accord in his pocket, Mr Verhofstadt must now turn from the future of Belgium to the future of Europe. Under the Belgian presidency, the EU is embarking on a constitutional debate that is supposed to culminate in a clear and durable division of responsibility between the EU and the countries that make it up. Yet Belgium’s own experience suggests that carving out a political settlement among mutually suspicious language-groups and cultures may be a process that never ends.

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Corsica

The perils of devolution

Jul 5th 2001 | AJACCIO
From The Economist print edition

More autonomy risks more danger too

WHAT price a second home in Corsica, France's justly-termed "Island of Beauty"? Not much if it falls foul of the island's aesthetically sensitive separatists. On June 7th the Corsican National Liberation Front (FLNC), the biggest of several feuding independence movements, announced a "building ban" on sites of outstanding natural beauty: two weeks later, the villa of a retired Parisian financier near Bonifacio, on the island's southern tip, was carefully blown to smithereens by three hooded FLNC gunmen. And the island expects more bombs, despite the truce declared by its armed groups in December 1999, when the central government headed by Lionel Jospin began talks to resolve Corsica's future once and for all.

Ironically, the reason will be Mr Jospin's willingness to give Corsicans some of the powers that the separatists have long demanded. The Jospin plan, due to be voted into law by the end of the year, will ensure that all schools offer classes in the Corsican language (a mere oral dialect of Italian, sniff some French-language purists); that Corsica continues to get favourable tax treatment; and that, assuming an appropriate revision of the French constitution, the island's politicians will from 2004 be able to amend national laws made in Paris. The plan will also cede to Corsica's own politicians the right to approve new building along its largely unspoilt coast. They may have a bigger stake in seeing it remain unspoilt than officials in faraway Paris. Alternatively, they may be even more susceptible to greed, clan loyalties or the threats of organised crime, when there is money to be made by pouring concrete over the coastline.

Referring to the hideously over-built Côte d'Azur, José Rossi, president of the Corsican parliament in Ajaccio (and also a member of the national parliament in Paris), chuckles: "As bandits, we're mere artisans; on the Côte d'Azur, they're industrialists." Other politicians are similarly relaxed. Paul Giacobbi, president of the council in the north of the island, argues that Corsica's coastline is almost 1,000km (625 miles) long, roughly the same as the French coastline from Spain to Italy—but Corsica has only 260,000 residents, a fifth of the number who crowd in and around Marseilles. Add to that a history of conservation going back to the 1970s, plus those bits of land too difficult to develop, and perhaps some 70% of the coast is already sheltered from the concrete flood.

Or perhaps not. A report to the government last year noted "the phenomenon of illegal building is marked simultaneously by its prevalence, its diversity and its dynamism." Jean-Guy Talamoni, leader of the separatist block in the Corsican parliament, promises to be "vigilant". But such a promise may be more easily given than kept. One fact of Corsica's economic life is that it will break its reliance on subsidies from the mainland—more per person than any other region of France—only if it increases either the number of its tourists (2.1m a year) or the money it earns from them. Meanwhile, another fact of Corsica's political life is that separatist violence sometimes has more to do with gangsterism than with green idealism.

Certainly, the rate of violence has gone down since Mr Jospin began the peace talks. Jean-Pierre Lacroix, the island's prefect, the quasi-colonial representative of the state, notes that in 1999 there were 210 explosions, of which 80 were "clearly political". Last year the figures fell to 110 and 24, the lowest for 25 years. And this year the rate is decreasing still further.

But the sceptics answer that Corsica's problems of corruption, crime and violence are endemic and permanent. Of Mr Lacroix's two predecessors, one was assassinated (his killer is still at large, thanks to the island's code of silence) and the other was disgraced for ordering an act of arson against an illegally-built beach restaurant. Perhaps Mr Jospin's interior minister, Jean-Pierre Chevènement, before resigning last year in protest at the very concept of devolution, had a point when he asked: "Do we want to see created in the Mediterranean an island ruled by an underworld that spends three-quarters of its energy settling accounts and internal battles?" Mainlanders with an eye on a second home may want to rent

rather than buy.

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The politics of Berlin

Ex-reds head for the bed

Jul 5th 2001 | BERLIN
From The Economist print edition

They used to run East Germany. Soon they may be helping to run Berlin

LITTLE more than a decade after the fall of the Berlin Wall, the Party of Democratic Socialism (PDS), successor to the Socialist Unity Party that ruled East Germany in Soviet days, could soon be elected to help run the city, now that the ruling coalition of Christian and Social Democrats has collapsed. The prospect, unsurprisingly, is raising passions.

Reuters

Who'd be afraid of Gysi?

Helmut Kohl, the Christian Democrats' long-serving but now former chancellor, has promised to intervene "massively" to ensure that the election, expected in the autumn, will not produce such an "appalling scandal". Mr Kohl is under a cloud these days, but he is still revered by many as the father of German unification. How much he can help the Christian Democrats is not clear, though. Opening their campaign this week, Angela Merkel, the party's chairman, Edmund Stoiber, boss of its Bavarian sister party, and other bigwigs were greeted by angry easterners with a hail of eggs, beer cans and other missiles.

For most of the 11 years since unification, the Democratic Socialists have been treated as pariahs by all Germany's main political parties, though they have attracted 20-25% of the vote in the country's five ex-communist eastern states, and as much as 40% in the eastern part of Berlin. But the past few months have brought signs of a rapprochement between the Social Democrats and their erstwhile bitter foes. Now there is talk of a possible "red-red-green" coalition should the Social Democrats and Greens not win enough seats to rule, together, on their own—as opinion polls suggest they may not.

The Democratic Socialists' campaign is led by their founder, Gregor Gysi. A punchy, witty and soothingly moderate-sounding former member of the Socialist Unity Party, he has an appeal well beyond his party's normal supporters. Indeed, some polls say he would be Berliners' preferred choice as mayor, though there is little chance of that. With about 20%, the PDS trails some ten points behind the Social Democrats in the city.

Outwardly at least, the Democratic Socialists are very different from their totalitarian forebears. Their ideas on the economy, foreign policy and defence are still fairly dotty. But they have rejected, albeit only as recently as 1998, the "dictatorship of the proletariat", and now formally embrace political pluralism and the principle of a mixed economy. Two of their leaders, though not the party as such, recently even apologised for the forced fusion of East Germany's Social Democrats with the German Communist Party in 1946. And now the PDS is preparing to express its formal "regret", though it will not "apologise", for the erection of the wall in 1961.

Pollsters say that six Germans in ten—and this includes over half of those in the western states—feel the time has come for the PDS to be treated as a normal party. Half would accept its inclusion in a centre-left local coalition in Berlin. But Germany's Office for the Protection of the Constitution remains worried. According to its latest report, extreme Marxist groups have infiltrated all the main organs of the party, which also has close links with other far-left extremist groups, many of them fond of violence. "All in all," the report concludes, the Democratic Socialists' "relations with the free, democratic order of the constitution remain ambivalent."

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Reforming Russia

Theory and practice

Jul 5th 2001 | MOSCOW
From The Economist print edition

Russia's government is proud of its new plans. Will they work?

WESTERN governments can usually manage two big reforms in a year, reckons Russia's prime minister, Mikhail Kasyanov. Yet his government, he notes proudly, is pushing through no fewer than eight. They include another tax reform, a land code (just through its first reading), a money-laundering bill (passed on second reading), a new pension scheme, changes to the judicial system and a slew of deregulatory measures aimed at lightening the crippling burden that corrupt bureaucrats impose on Russia's businesses.

AP

Putin speaks, Kasyanov listens

Mr Kasyanov is bullish. For a start, he is now the second-longest-serving prime minister since communism collapsed a decade ago. His 14-month stint has confounded constant rumours and predictions that he, like five of his predecessors, would be sacrificed to Kremlin whims. And unlike his predecessors he has a fairly sensible parliament that looks seriously at his draft laws and then passes them. Previous legislatures were much more trouble.

In the first months of this year, though, the government seemed to be running out of steam. The only reform that had clearly worked was one that brought in lower and simpler taxes—including a 13% flat rate of personal income tax. Thanks partly to that and partly to the oil boom, tax revenues are up by around a fifth in real terms. But trickier reforms on land, deregulation and the few restraints on Russia's woefully unaccountable prosecutors all fell foul of entrenched interests. Changes to the customs system created huge queues, but failed to help companies engaged in foreign trade.

Now, at least on the surface, things are looking better. Laws are whizzing through parliament before it starts its summer holidays on July 12th. A new code to set up a proper market in urban land, raising the possibility that even agricultural land may be bought and sold in future, enraged the normally dozy Communist opposition—but the code was enacted anyway.

Mr Kasyanov says that his reforms have reached a "second stage", with amendments to the central-bank law in the offing to ensure greater accountability. That is good news, for the central bank has hitherto impeded serious attempts to clean up Russia's swampy banking industry, turning a blind eye to speculation in precious metals and to a peculiar network of Russian banks abroad.

Needed: a culture change

Yet, though the government may win its tussle with the central bank, it will be much harder to make broader changes work. How to turn paper into good practice has stumped Mr Kasyanov's predecessors for centuries. Much of life in Russia is governed by a web of informal relationships, many of them involving corruption or backscratching. Living by the book usually costs more in time and money than does taking short cuts. For all its inefficiency and unfairness, most Russians in business prefer the system they know.

Changing that would mean a huge cultural shift. Better laws are just one necessity. Another is a better civil service. Even the bits of government keenest on reform still work poorly, shuffling huge piles of paper from ministry to ministry. Getting your bit of paper to the top of a pile for signing still needs a lot

of clout or cash.

Russia's recent row with the World Trade Organisation, which sets rules for international business in the rich world, highlights the problem. The Russians have become increasingly huffy about the WTO's attempts to make their laws and procedures fit international norms. This week talks about membership for Russia fizzled out, with the Russians complaining that the WTO had been nitpicking.

Mr Kasyanov says that the government is "working more effectively all the time", and has already started cutting the number of bureaucrats and requiring better qualifications. So far, it does not show. The prime minister also plans to switch all internal communications from paper to e-mail next year. And he wants to bring in a law so that bureaucrats and state agencies can be sued for showing favouritism or for incompetence. There has been talk of a freedom-of-information act.

First steps towards reforming the courts should make them more efficient, although not necessarily fairer. The idea of freedom of information, however, draws a blank prime-ministerial stare. An aide quickly scribbles a note about ministry websites. There you are, says Mr Kasyanov breezily, expressing his government's ardent desire to work closely with the media: the "openness problem" is all but solved.

The carping Kremlin

That rings hollow. Though economic reforms are going ahead, things look much bleaker on the political front, especially in the media. The authorities are squeezing two of Russia's doughtiest independent outlets that still carry weight, TV6 and the Echo of Moscow radio station. Muzzling the press may remove one source of worry for Mr Kasyanov, a quick-witted former debt negotiator whom high office has turned from bruiser to smoothie. But his biggest problem will not go away: the Kremlin, which happily spreads rumours of the government's supposed incompetence and impending dismissal. Though Mr Kasyanov's team administers Russia, real power lies with President Vladimir Putin and his chums. Praise goes one way, blame the other.

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Yugoslavia's divisions

Who's in charge?

Jul 5th 2001 | BELGRADE
From The Economist print edition

The Milosevic effect continues to trouble Serbia and Montenegro

FOR a dozen years the figure of Slobodan Milosevic towered over the Balkans, leading it into war, destruction and poverty. Then, when he fell last October, optimists hoped that a sunnier era would begin. Alas, in the words of one of Serbia's deputy prime ministers, Mr Milosevic may have "died politically, but he...continued to suck our blood like a vampire". Can his fangs still threaten the Balkans now that he is locked up in The Hague, facing trial before a UN tribunal?

AP

Djindjic pulls the strings

With Mr Milosevic out of power but still in Serbia, the new federal government had been struggling. Goran Svilanovic, foreign minister of Yugoslavia (which comprises both Serbia and tiny, disaffected Montenegro), laments that the government has been unable to tackle reform because it has been "overwhelmed" by unexpected problems. Not least was western governments' insistence that it must hand over Mr Milosevic to UN justice before they would distribute significant quantities of cash to rebuild the NATO-battered country. Yet most Serbs wanted the former president tried at home.

In the past few weeks the ground in Serbia has shifted—sometimes literally. Mass graves of Kosovo Albanians killed there in 1999, including many women, children and old people, have been dug up. The corpses had been transported hundreds of miles into Serbia proper by Mr Milosevic's security forces, to hide the evidence of their crimes. The disgust felt by ordinary Serbs at these revelations paved the way for their former leader's extradition.

It was Zoran Djindjic, Serbia's prime minister, who on June 28th decided to act. Pro-Milosevic Montenegrins in the Yugoslav parliament had blocked the passage of a law that would have enforced co-operation with the UN's tribunal. Then the Supreme Court suspended implementation of a decree to the same effect. Mr Djindjic ordered that Mr Milosevic should be flown to The Hague anyway, arguing that a Milosevic-era provision in Serbia's constitution gave Serbia primacy over Yugoslavia if the Serbian authorities judged that federal institutions were not working.

The order came just a day before a donors' conference in Brussels. The closed chequebooks were duly opened, to the tune of $1.28 billion in promised aid and grants. Many Serbs also noted that it was St Vitus's day, the biggest date in their calendar. On this day, the Turks slaughtered the Serbs at the still remembered battle of Kosovo in 1389; the assassination of Archduke Franz Ferdinand in Sarajevo sparked the first world war in 1914; Stalin expelled Yugoslavia from the communist block in 1948; and in 1989 Mr Milosevic first served warning, at a giant Serb rally in Kosovo, that the old Yugoslavia's squabbles might turn violent.

Mr Milosevic's extradition has provoked yet another crisis in Yugoslavia, whose government collapsed as Montenegrin ministers favourable to him, including the prime minister, walked out. Yugoslavia's popular president, Vojislav Kostunica, was humiliated, claiming he had heard of the extradition only from a news broadcast. Mr Kostunica's rivals in the Djindjic camp cast doubt on that, saying he had washed his hands of Mr Milosevic, but wanted to keep Serb nationalists sweet while gaining credit for the money pledged to Yugoslavia in Brussels.

Serbia rules

The extradition proves two things. First, real power in Belgrade, the capital both of Serbia and of the Yugoslav federation, lies with the Serbian rather than the federal authorities. Second, the federation must be either refashioned completely or dissolved. The irony is that the Montenegrin party whose ministers walked out of the federal government, thus causing it to collapse, wants Yugoslavia to survive. Since their departure the party has issued contradictory messages, calling for a new Yugoslav election while suggesting that it might rejoin the federal government or support a minority one.

Montenegro itself is deeply divided over whether it should become independent. Ten weeks after a general election won narrowly by supporters of independence, the republic has just got a new government, which aims to hold a referendum on independence by next January. But Montenegro's president, Milo Djukanovic, has recently implied that he might be more flexible on the issue than he was. He gets on well with Mr Djindjic, who says he is willing to talk about a new Yugoslav federation in which Serbia and Montenegro are both independent in all but name.

Dynamic Mr Djindjic is plainly gaining strength, yet he lacks Mr Kostunica's popularity. He will feel that lack when he has to handle other troubles already looming. What, for instance, will he do about Serbia's president, Milan Milutinovic, who is also wanted by the UN? None of Serbia's leaders wants to extradite him now, since that would provoke a bitter battle for his post. It could again become the most powerful one in the country, as it was when Mr Milosevic held it before taking the federal presidency. The rivals would probably include Mr Djindjic and Mr Kostunica, in a battle that neither man yet wants.

Whoever is in charge, the mood in Serbia could turn nasty again—and more nationalistic—unless people start feeling better off. That sort of change would not help solve such problems as Serbia's future relationship with Kosovo, now run by the UN; Kosovo's ethnic-Albanian majority would probably return to war rather than see any link with Belgrade.

Instability in one bit of the Balkans can too easily lead to instability in another. If Kosovo turns messier again, so will Macedonia, once a part of Yugoslavia. Envoys from the European Union and the United States arrived there last week hoping to arm-twist Macedonia's large ethnic-Albanian minority and its Slav majority towards a peace deal, to be overseen by NATO. This week they pushed the politicians into a first step that way, and the guerrillas into accepting a mutual ceasefire. But will more follow? This conflict cannot be blamed directly on Mr Milosevic, but it is part of his legacy. He may be politically dead, but his ghost will continue to haunt the Balkans for years.

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Charlemagne

Pascal Lamy

Jul 5th 2001
From The Economist print edition

The EU's trade commissioner with a finger on a nuclear button

THIS week's refusal by the European Union to countenance the merger of two giant American companies, Honeywell and General Electric, has already caused outrage in the United States (see article). But even before this new source of friction came between the world's two biggest trading blocks, a "nuclear device" was ticking below them, and Pascal Lamy, the EU's trade commissioner, has had his finger on the button. Lest this sound a touch melodramatic, be it said that the image is not Charlemagne's. It was Robert Zoellick, Mr Lamy's American opposite number and friend, who used it when discussing the possibility that the EU might impose billions of dollars of trade sanctions in its challenge to the United States' "foreign sales corporation" tax code, which it sees as a subsidy to American exporters.

Last month the EU won an interim ruling against the code at the World Trade Organisation. But getting it dismantled may prove tricky. Neither the Bush administration nor Congress is famed for tolerance of multilateral constraints on American freedom of action; the EU's decision to block the General Electric-Honeywell merger will hardly encourage them to comply with the WTO ruling. So the time may come when the EU could, in theory, slap up to $4 billion of sanctions on American exports. Since the case is still before the WTO, Mr Lamy will not discuss how itchy his finger may be. And, of course, the commission could not launch a war of mutually assured destruction—for such it would be—on its own: it would have to get Europe's political leaders behind it. But Mr Lamy's views will count.

The fact that he is a French Socialist will not reassure those in Washington who think the EU is spoiling for a fight. But Mr Lamy is no stereotypical American-bashing Frenchman. Keenly aware of American politics, he talks knowledgeably of the need to woo Congress and calls up a website to illustrate the exact progress of the confirmation hearings for George Bush's new appointees. In both work and leisure habits, he inclines more to American-style workaholism than to the 35-hour week that is now the law in his own country: the long hours he puts in are notorious, and his idea of relaxation is to run the New York marathon. Oh, and he speaks impeccable English.

Mr Lamy himself pointedly refrains from resorting to America-bashing. "I know the easiest way to get a cheer in Brussels is to stand up in the European Parliament and denounce America," he says, "but that's why you need telephone diplomacy, not megaphone diplomacy." He is proud that he and Mr Zoellick recently settled the long-running dispute over bananas. And, like the Americans, he sounds both keen and optimistic over the biggest trade question, whether this year will see the launch of a new round of world trade talks. But on one of the thorniest issues, agriculture, he is all European. Jacques Delors, the French former head of the European Commission, once remarked during a previous trade round that he would not sacrifice the French countryside on the altar of free trade. Mr Lamy, who was Mr Delors's chief of staff, stands firmly in this tradition.

Agriculture, he insists, cannot be seen as just another economic sector; it has a wider social significance. If European food prices were allowed to fall to world levels, he reckons that the EU would lose 5m of its 7m farmers. Alarmingly—given Japan's notorious protectionism—he sees strong affinities between European and Japanese attitudes to farming. Both cultures are concerned with food security, he says; both abhor a wilderness and believe that land is there to be cultivated. Of course, he agrees, agriculture will figure large in a new trade round. But, given his views, it is hard to foresee much progress on it.

Doing the splits

Mr Lamy's approach will disappoint free-traders. But it may still go too far for many in his natural political tribe, the French left. One of the loudest voices of the anti-globalisation movement is José Bové, a French farmer. Asked if he sympathises with Mr Bové, Mr Lamy—after a long pause—gives an anodyne reply: Mr Bové raises good questions but has the wrong answers.

The same desire simultaneously to keep faith with his political base and yet adapt to current realities colours Mr Lamy's approach to the subject that is his real passion, the future of the EU itself. As Mr Delors's former right-hand man, he is in an ambiguous and sensitive position. Many commission staff still hark back to the glory days of Mr Delors, when the commission drove forward European integration. Some French civil servants and politicians also deplore the way in which an "Anglo-Saxon" emphasis on market economics has allegedly displaced grander political and social visions of Europe's future. Mr Lamy cannot endorse such criticisms openly, since to do so would be dangerously disloyal to his current boss, Romano Prodi, the hapless Italian head of the commission. Yet on occasions Mr Lamy will signal his unhappiness. He fiercely opposed a recent decision not to press for harmonisation of corporate-tax rates—something which the French prime minister, Lionel Jospin, has demanded. Mr Lamy is unrepentant in his opposition to the current commission line, insisting that "I definitely think fiscal competition should not take place."

His critics in Brussels, and there are plenty, will take such statements as proof of their suspicion that, for all his talk of Europe, Mr Lamy is ultimately a French nationalist, pushing a distinctly Gallic—more precisely, Gaullist—view of Europe's future. Maybe. But then commissioners in Brussels who happen to be British or German also often promote ideas that reflect their national prejudices. And when it comes to wearing his trade hat, Mr Lamy's background on the French left may even prove an advantage. Just as it used to be said that only a right-wing Republican like Richard Nixon could reconcile the United States with China, so it may take a French Socialist to reconcile Europe to a new round of trade liberalisation.

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Northern Ireland

Will peace go down with Trimble?

Jul 5th 2001 | BELFAST
From The Economist print edition

Reuters

The crisis is serious, but there may just be a way out

Get article background

THE IRA refuses to move towards decommissioning its weapons; the Good Friday Agreement teeters on the brink of collapse; the British and Irish governments are in feverish conclave in a bid to stitch together a last-minute rescue plan. This has happened at least three times since a peace agreement was signed in April 1998 opening the way for power-sharing in Northern Ireland. Each time the Irish and British prime ministers, Bertie Ahern and Tony Blair, have managed to bring things back from the edge and the peace process has stumbled on until the next crisis.

This time it could be different. What makes this problem a crisis is the pledge that the Ulster Unionist leader, David Trimble, made before the general election to resign as first minister of the devolved Assembly on July 1st, unless the IRA honoured a year-old promise to start “putting its weapons beyond use”, as the curious language of Irish peacemaking puts it. The IRA ignored his deadline so Mr Trimble’s resignation came into effect.

Mr Trimble has done the local equivalent of going to Def Con 2—not quite time for the missile to launch, but almost. Mr Trimble’s successor, who could be himself, must be chosen by the Assembly within six weeks or fresh elections must be held. After that, no one can stop the rocket.

In practice, the deadline may be even closer. Both prime ministers have a full diary after July 15th—Mr Blair at a G8 meeting and Mr Ahern on a trip to South America. After that the summer holidays beckon, so most participants have set the weekend of July 14th-15th as the effective deadline for a deal.

In one sense the portents are not good, especially on the Unionist side. Mr Trimble is weaker now than at any point since the peace process began to get serious. He has just emerged from a disastrous general election which saw the rival Democratic Unionist Party (DUP) led by Ian Paisley take three seats from him. Inside his party the vultures are circling.

This crisis is also happening at the worst time of year, when Protestant Orange Order marches through Catholic districts threaten to inject street violence into an already unstable situation. Fresh elections to the Assembly in these circumstances would almost certainly strengthen the DUP further.

The last time the peace process faced such a crisis Peter Mandelson, the former Northern Ireland minister, stepped in to save Mr Trimble. The Good Friday Agreement was suspended until another deal could be put together. This time Mr Mandelson's successor, John Reid, has stayed his hand, showing a hesitancy that suggests that the British government may not have written off the Good Friday Agreement, whatever Mr Trimble's ultimate fate.

The reason is that since his bad election, Mr Trimble has been obliged to include in his negotiating team one of his leading critics, the MP for Lagan Valley, Jeffrey Donaldson. Although a strong opponent of the deal in the past, these days Mr Donaldson is doing little to discourage the view that he would really like to see it survive and even become a member of the power-sharing administration—but only if the IRA deals with its weapons.

Mr Donaldson was a member of Mr Trimble's team when the Good Friday Agreement was negotiated, but he broke with his leader over the lack of any specific language committing the IRA to dispose of its weapons. His role now means that any deal Mr Trimble brokers must pass the Donaldson test. The Unionist leader has, in effect, already handed the reins of power to his rival.

This turn of events has opened up an encouraging possibility. The scenario goes like this: a deal is put together which passes the Donaldson test; Mr Trimble quits as party boss and Mr Donaldson takes over; a stronger figure than Mr Trimble, Mr Donaldson restores some of his party's natural vigour; the Good Friday Agreement stabilises.

Whether this can happen is in the hands not of the British and Irish leaders but of the seven men who sit on the IRA's Army Council. As it happens, conditions could not be better for a major move on decommissioning. Sinn Fein had a splendid general election, doubling to four its complement of Westminster MPs and overtaking, earlier than most had expected, the moderate Social Democratic and Labour Party (SDLP). The party is now well placed to win seats in the Irish parliament in Dublin and could even enter a coalition government after the next Irish general election, scheduled to happen in the next six or nine months. The peace process in the north is enormously popular with southern voters. If it collapsed and republican stubbornness were held responsible, the party might lose its best chance to enter government in Dublin.

The stakes are as high for the republicans north of the border. Fresh elections to the Belfast Assembly must be held in 2003 and if Sinn Fein's recent performance is repeated then it will be Martin McGuinness or even Gerry Adams who will step into the deputy first minister's office next time, not the SDLP's Seamus Mallon. If the deal collapses, that will not happen.

Each crisis in the peace process has been overcome because all its participants want it to survive. Power is intoxicating even for extremists. As they prepare for what could be the most crucial talks yet in the Irish peace process, Messrs Blair and Ahern will be hoping that the bleak prospect of direct rule from London will concentrate minds.

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Anti-British riot in Cyprus

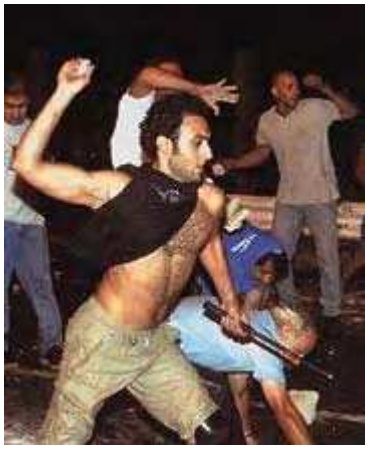
Matsakis and the mast

Jul 5th 2001 | NICOSIA
From The Economist print edition

Angry Cypriots threaten Britain's Middle East intelligence-gathering

MARIOS MATSAKIS, a Greek-Cypriot, British-trained physician (his speciality is carrying out post-mortems) who is also a parliamentary deputy, has strong views about the new communications antenna planned to go up at RAF Akrotiri, one of two British military bases on Cyprus. He calls it "satanic", saying it poses a health hazard for local residents and will cause environmental damage because radiation from it will threaten birds and plants at a nearby salt lake.

AP



Pass the cabbages

On July 2nd, Mr Matsakis climbed an existing 58-metre (63-yard) mast on the Akrotiri base and sat aloft for six hours. The next day, when he returned to continue the protest, he and a television cameraman were arrested by Greek-Cypriot police. The two were quickly freed when a crowd of angry Greek-Cypriots turned up at the Akrotiri police station. Nevertheless, the incident turned into an anti-British riot. The demonstrators threw stones, cabbages and ripe melons, and set fire to cars, while about 200 soldiers and police in riot gear fired tear gas and water cannon. About 40 people were injured, most of them Greek-Cypriot police, but five soldiers from the King's Own Border Regiment were among them. The police station was trashed. Around C£400,000-worth ($590,000) of damage was done.

The two bases, 99 square miles (256 sq km) of sovereign British territory under the 1960 independence agreement with Cyprus, are an important part of Britain's defence-communications network. The new 190-metre antenna will help keep Britain in the front rank of Middle East intelligence-gathering, and entitled, in exchange, to a fair whack of information from America. Construction of the antenna site has started, and the mast is due to be mounted in two years' time and to start operating in 2004. Britain says it won't operate the antenna if emissions tests identify a health risk. Greek-Cypriots say the tests should take place before it goes up.

Glafcos Clerides, Cyprus's president, was quick to criticise Mr Matsakis for taking the law into his own hands. His right-wing government will do its best to resolve the dispute amicably. The Greek-Cypriots are entering a critical stage of negotiations to join the European Union in the first wave of enlargements, and they need all the help they can get. They will have no difficulty meeting all the economic requirements, probably in 2001. But there is no guarantee that they will be allowed to join without a political settlement with the Turkish-Cypriots who run their own—internationally unrecognised—state in the north of the island, and who say they don't want to join Europe until Turkey is allowed in, too.

After almost 27 years of acrimonious division, it may be too much to hope for any kind of formal re-unification. But a lot of weighty EU types, including France, Germany and the Netherlands, are reluctant to accept a divided state as a new member. So Mr Clerides can't afford to risk losing British backing for Cyprus's accession bid. Even if it means putting up with more trouble from Mr Matsakis and his green supporters.

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Wimbledon

Fault!

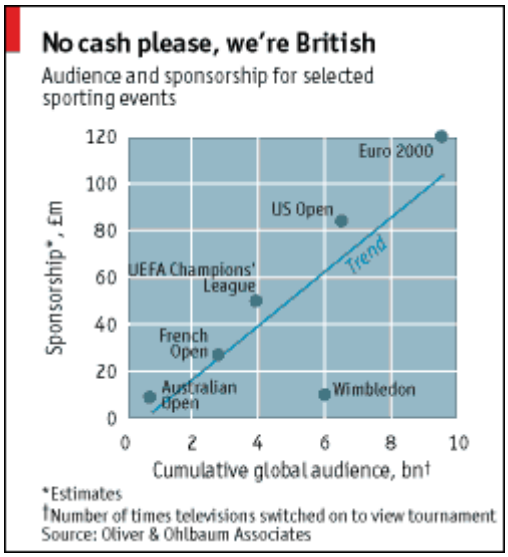
Jul 5th 2001
From The Economist print edition

Wimbledon bats away sponsorship. That serves nobody

THE British like grumbling, and they like tennis too. Wimbledon fortnight provides them with the perfect opportunity for both. Despite Tim Henman's sterling performance, bickering about the mediocrity of British players has been as vicious as ever. Last week John Crowther, who heads the Lawn Tennis Association (LTA), which governs tennis in Britain, called the results of British tennis players "absolutely pathetic". But what is less often suggested is that Wimbledon, which is run by the All England Lawn Tennis Club (AELTC), is itself underperforming.

Wimbledon has made an annual profit of around £30m ($42.2m) for several years. Oliver & Ohlbaum Associates, a media and sports consultancy, estimates that Wimbledon reaps £10m each year from sponsorship by companies such as IBM and Rolex. Compare that with the US Open tennis tournament, which has similar audience figures but now earns $118m (£84m) from sponsors (see chart). Given the size of its audience, Wimbledon could probably earn £50m more from sponsors.

That it does not is no accident: it is the deliberate choice of the AELTC. "We could do a lot of things in the short term," says Robert McCowen, who is the club's marketing director. But in the long term, he says, "the unique character of the event" might be damaged. "We're not just there to make financial income," he explains. Few at Wimbledon would follow the example of Australia, which proudly opened its new Vodafone Arena last year. But some types of sponsorship are more discreet than others. Affinity branding, for example, where companies pay to use the Wimbledon brand on their products, would hardly damage the event's character.



The lack of advertising at Wimbledon may not even be beneficial. Mark Oliver, of Oliver & Ohlbaum Associates, thinks it "reinforces an exclusive image of tennis, which affirms it as a middle-class sport for middle-class people." British tennis won't recruit young talent from across the country if Wimbledon appeals to a minority.

Mr McCowen does not deny that he could increase profits, but he claims that by keeping Wimbledon uncommercial, he is acting "in the public's best interests". But the public wants to see better British tennis players. The fear of tawdry commerce ignores their priorities. Since Wimbledon's profit goes to the LTA to improve British tennis, more profit would probably mean better tennis.

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About sponsorship

Public relations

PR man in father-in-law slur shock

Jul 5th 2001
From The Economist print edition

Matthew Freud is not just a consummate networker: he has helped change the nature of celebrity in Britain

IN 1994, Matthew Freud sold his public-relations company, Freud Communications, to Abbott Mead Vickers, an advertising agency, for £10m. On July 1st this year, he bought it back for £10m ($14m). That says less about the company's potential than about the bargaining power of Mr Freud, who is the king-pin of Britain's celebrity public-relations business.

AP

Murdoch and Freud, celebrity partnership

Mr Freud's success is partly the result of the increasing size and silliness of the media business. When Mr Freud, a 37-year-old great-grandson of Sigmund Freud, started his company in 1985 with £250, the media business was relatively small and serious. Since then, the volume of newsprint has increased hugely, commercial radio stations have proliferated, pay-TV has multiplied the amount of television airtime that needs filling, and all these outlets have travelled relentlessly downmarket. British national newspapers are more plentiful, more competitive and more frivolous than those anywhere else in the world, so the demand for the stuff that Mr Freud peddles is commensurately large.

Unlike Max Clifford—a publicist who specialises in tabloid exposés of public figures—Freud Communications, whose turnover reached £6.7m last year, derives its income from its clients, rather than from selling stories to newspapers. Among those clients are Chris Evans, a disc jockey, Geri Halliwell, a pop star, and Steve Coogan, a comedian.

Mr Freud's legendary networking abilities have enabled him to bring off numerous PR coups, for instance Miss Halliwell's endorsement of the Labour Party before the general election. Mr Freud had met the Blairs through his old friend, the former Northern Ireland secretary, Peter Mandelson. Miss Halliwell, a former Thatcherite, was persuaded to renounce her previous political beliefs. Whether the endorsement did the Labour Party any good is debatable; but for Miss Halliwell, who had an album to plug, it was just fine.

But contacts are not enough: it's what you do with them. Mr Freud is recognised as the best in the business at turning celebrity into cash by bringing together the interests of the media and the consumer-goods industry. He persuades a brand to buy into what he calls the "equity" of a celebrity's fame, then obtains editorial exposure for both the brand and the celebrity. It is a neat arrangement that Mr Freud first put into practice in 1992 when he organised the publicity surrounding the London opening of a hamburger restaurant, Planet Hollywood—using the presence of Hollywood stars like Sylvester Stallone, Bruce Willis and Eddie Murphy to help shift merchandise. As Mr Freud once pointed out: "It was the ultimate transfer of celebrity equity into a T-shirt."

Last month, Cat Deeley, a 24-year-old British television presenter, featured in *Hello!* and *OK* magazines, five tabloid newspapers—including two covers—as well as the cover of the *Sunday Times* style section, wielding the new Braun Oral-B3-D Excel electric toothbrush in every photograph. Mr Freud negotiated Miss Deeley's contract with Oral-B.

Such is the demand for celebrities, these days, that there is business for the PR men even at humbler levels. *Hello!*, a celebrity magazine that pays big stars up to £500,000 to show readers their "beautiful" homes, will fork out £10,000 for an interview with an evicted housemate from the reality programme, "Big Brother".

Fame is capital for Mr Freud's clients; and ensuring that the stars' capital does not erode is a delicate business, given the celebrity appetite for self-destruction. According to Digon Freeman, an editor on *PR Weekly*, Mr Freud controls what parties Miss Halliwell attends, what she wears—even with whom she has lunch.

"It's all about publicists reinvigorating careers with carefully orchestrated appearances until the celebrity ends up opening the local branch of Tesco," says Nicholas Coleridge, a journalist and author who is now managing director of Condé Nast Magazines in Europe. When their careers start to falter, celebrities can make some mileage out of their personal lives. Even a spell in The Priory, a drugs-and-drink rehabilitation clinic favoured by stars, now begins and ends with a press conference. Eager to cash in on all the publicity, The Priory employs its own publicist.

The rehab story, though, is usually a sign that a star is spending the last vestiges of their capital. Mr Freud is always conscious of the need to reinvest. We will not, apparently, be reading much about Miss Halliwell over the next six months: "I'm trying to build up her equity bank," says Mr Freud. But there is an irony in Mr Freud's careful conservation of the capital of individual stars. Celebrity as a whole has been devalued, and Mr Freud, as he admits, has played a part in that process. "With very few exceptions, the famous are no longer interesting."

This week the limelight has turned on Mr Freud, for an interview he has given to *Vanity Fair* magazine in which he casts aspersions on the attitude of his prospective father-in-law, Rupert Murdoch, to women. Mr Murdoch owns the *Sun* and the *News of the World*, two tabloid newspapers that are crucial to Mr Freud's business. Perhaps Mr Freud is better at managing others' public relations than he is at looking after his own.

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About sponsorship

Public services and private companies

The unions dig in

Jul 5th 2001
From The Economist print edition

One step forward, two steps back for the government's plans

THE government's enthusiasm for greater private involvement in the provision of public services has, one way or the other, succeeded in alarming just about everyone. Attempting to reassure the unions about pay and conditions in outsourced services, ministers have succeeded in disgruntling private companies. The wrangle is important, because if private companies don't have the freedom to manage their employees properly, private provision is unlikely to prove economical—for the companies, or the government.

The noisiest opposition last week was provided by the British Medical Association (BMA) conference in Bournemouth. Doctors added Labour's hazy private plans to their familiar grievances over workload, bureaucratic burdens, and the calumnies heaped on them by politicians and the press. But the BMA's avowed anxiety about the private sector seems a bit odd, given the fact that one of its main gripes is over a government plan to restrict the private practice of consultants. On this particular question, the opposition of the bluer-collar unions, principally the public-sector giant Unison, is a bigger problem for Labour. Unison members may be lowly homunculi compared to the doctors, but they are necessary homunculi.

Unison is worried about what happens when services—formerly administered directly by NHS trusts, local authorities and so on—get transferred to private contractors. Employment regulations dictate that existing workers take most of their terms and conditions with them. But the unions worry that these get eroded when job descriptions change, and that new employees can be hired on much less advantageous terms, creating a two-tier workforce. Private companies also tend to be less sensitive about sacking people.

Are they right to fret? There is evidence of private companies increasing profits by paying new workers less than their colleagues. On the other hand, Norman Rose, of the Business Services Association, a policy forum for outsourcing companies, argues that such companies generally make money by being more efficient. As public-sector purchasers expect, Mr Rose says, private companies pay the market rate for labour. The truth is that, as in any sector, there are both good and bad employers. (There are also both good and bad contractors: some of the dirtiest hospitals are privately cleaned.)

The unions, however, remain suspicious; and, in an effort to mollify them, the government has come up with what looks like a "third way". Last month it announced that in three pilot hospitals, some ancillary staff—cooks, cleaners, porters and others—will remain NHS employees, with attendant benefits, even though they will be managed by private companies under the Private Finance Initiative. New staff will be hired on the same basis.

In these pilot schemes, the private contractors will manage staff on secondment from the NHS, which may or may not be workable. Either way, other PFI schemes are likely to be delayed, until the private consortia involved know what to expect from this new arrangement. "It's a frustrating step", says David Metter, chief executive of Innisfree, which is bidding for one of the pilot contracts. This wheeze may look like progress towards resolving the current furore; in reality, it is a retreat.

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About sponsorship

Marconi

Industrial mess

Jul 5th 2001
From The Economist print edition

While domestic demand remains strong, Britain's exporters are suffering

"CAN I make it absolutely clear, Marconi is financially sound," said Lord Simpson, Marconi's chief executive, announcing a profits warning on July 4th after trading in Marconi's shares was suspended. "The thing that has really changed is how customers in Europe have really turned off the tap in capital expenditure." Investors were not reassured. When trading in the shares resumed on July 5th, their price halved (see chart).

Marconi's sales this year are expected to be 15% lower than they were last year. Profits are expected to be 50% down. Some 4,000 jobs are to go around the world, on top of losses of 3,000 announced earlier this year. On the same day as it announced its profits warning, Marconi said that it was selling its medical systems business to Philips, the Dutch electronics group, for £780m. Earlier estimates of what Marconi would get were up to 35% higher.

Marconi was already in trouble for what many investors regarded as dodgy corporate governance. In June, as its share price slid, it proposed repricing share options. Repricing options makes a nonsense of the principal justification for share options, which is that they align the interests of managers with those of shareholders. But with the share price on the floor, the argument is theoretical.

Managerial shenanigans aside, the troubles at Marconi are different in scale, but not in kind, to those of many other British exporters. All are suffering from the slowdown in the American and European economies. The telecoms and IT sectors, which make up a higher proportion of output in Britain than in France and Germany, are doing particularly badly.

Marconi is not the only bad news around. A survey by the Engineering Employers' Federation, published earlier this week, recanted the hopes the organisation had expressed earlier this year of a revival in the sector. "These hopes have been dashed by weakening world markets and the sharp downturn in key industries. We expect that the next official data will confirm engineering is almost certainly in recession, with output, orders and margins all heading downwards," says the EEF's chief economist, Stephen Radley. The EEF has revised downwards its estimate of growth in the sector in 2001 to 0.7%, the lowest level since 1993. It blames "a combination of the US slowdown and jitters in the technology markets. This has been compounded by growing weakness in Europe, with manufacturing contracting in several countries."

While exporters are suffering, domestic demand remains strong. Britain's economy is expected to grow at 2.2% this year. Among the G7 group of industrial countries, only Canada is likely to grow faster. Unemployment is low, at below 1m, and falling. In some areas of the economy, demand is alarmingly strong. House prices are still rising—latest figures suggest that they are increasing by nearly 10% a year—and retail sales are growing at their fastest level for four years.

Exporters have been calling for lower interest rates, which would both cut their borrowing costs and help reduce the value of the pound, thus giving exports a boost. But the principal effect of cutting interest rates is to boost domestic demand, which would risk raising inflation. That is why the Bank of England announced on July 5th that it was keeping rates steady.

The best hope for closing the gap between the export and domestic markets is that the world economy picks up and demand for British goods abroad rises. A less cheerful possibility is that the gloom abroad feeds into Britain through its impact on exporters, and the pain it is inflicting on companies such as Marconi spreads across the economy.

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About sponsorship

London School of Economics

The brain trade

Jul 5th 2001
From The Economist print edition

Rather like the Asian countries from which so many of its students are drawn, the LSE grew out of poverty and obscurity by exporting

ON JULY 12th, the London School of Economics (LSE) will be opening a new £6.5m "research lab", part-funded by the government and the Wellcome Foundation, which claims to bring together "the largest concentration of social sciences and economic expertise outside the US". Any other university would be content with a research centre; the LSE has to have a lab. Nor is this lab designed by any old jobbing architect, either. It is the work of the high priest of modern British architecture himself, Lord Foster.

The lab represents yet another little victory for the LSE over its immediate rivals, Oxford and Cambridge. The plans for the opening ceremony also show what a good networker the place is. The lab will be opened not by a couple of moth-eaten professors, but by Gus O'Donnell, the head of the Government Economic Service, and Nick Stern, the World Bank's chief economist. The director of the LSE and intellectual mentor to Messrs Blair and Clinton, Tony Giddens, will preside.

Two decades ago the LSE was still the poor relation of the University of London's other colleges. Now, together with London's other great success story, the Imperial College of Science and Technology, it regularly follows Oxford and Cambridge in league tables of research output and teaching quality and is at least as well-known abroad as Oxbridge.

The LSE owes its success to the single-minded, American-style exploitation of its brand name and political connections by the recent directors, particularly Mr Giddens and his predecessor, John Ashworth. Unlike Oxford and Cambridge, the LSE, founded in 1895 by the socialist Fabian Society, started with very little money and has had to find its own revenue stream to fund expansion. Its site, worlds away from the medieval beauty of Oxbridge, is a poky complex of rooms in the Aldwych.

The modern expansion has been funded largely by attracting foreign students. Tuition fees for a British undergraduate, paid by the student, are £1,050, and the university gets around £3,000 more from the government per head; overseas students pay £9,619. The LSE now relies on foreign students for 42% of its income. While Oxbridge has become mired in the debate over widening access to poorer British students, only 40% of the LSE's students come from Britain at all. Some 18% are from the rest of the European Union, and 42% from elsewhere.

The LSE has thus been able to afford to reverse the "brain drain". Whilst other British universities have had to watch all their best staff being pinched by rich American universities, the LSE has been able to poach famous foreigners. A recent arrival has been the urban sociologist Richard Sennett from Columbia University. His equally celebrated sociologist wife, Saskia Sassen, also teaches at the LSE. Such stars keep the overseas students rolling in.

Being located next to Bush House, home of the BBC's World Service, and an easy walk from much of the capital's media, has done the LSE no harm. It bothers with public relations in the way that few British universities, and almost all American ones, do.

Despite its image as a hot-bed of student radicalism and alternative politics earned during the 1960s, the LSE has always been good at exploiting its political contacts. Its connections to government and Whitehall are better than those of any British university. Just as the Fabians invented modern British socialism, so Thatcherism was made in the economics department of the LSE. And Mr Giddens is the guru of the "third way", Mr Blair's preferred path. That may not assure the university a place in the history of political philosophy; but it always helps to have powerful friends.

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Cannabis

Brixton lights up

Jul 5th 2001
From The Economist print edition

The first step to decriminalising drugs

EIGHTEEN months ago the Police Foundation, an independent research body partly funded by the Home Office, warned ministers that Britain's archaic drugs laws were in urgent need of reform. In particular, it stressed the need to distinguish more sharply between the possession of soft drugs such as cannabis and more addictive drugs such as heroin and cocaine. At present possession of cannabis can be punished by up to five years in jail under the 1971 Misuse of Drugs Act. The response from government to this report, the most comprehensive review of drug legislation for a quarter of a century, was to reject it out of hand as sending out "all the wrong messages".

But suddenly things seem to be changing. A trial which has just begun in South London allows anyone caught with cannabis to be given an informal warning rather than being arrested and cautioned or prosecuted. As each cannabis arrest takes two police officers off the street for up to five hours, and the process of taking a cannabis suspect to court costs up to £10,000, the pilot scheme makes sense. A report which charted the cases of 141 people arrested for cannabis possession in Lambeth last year found that the average fine was only £45 and nearly a quarter were given a conditional discharge.

This trial, and the publicity it has received, may have something to do with a change of home secretary. David Blunkett, the new home secretary, has said that he is in favour of the experiment. It is hard to imagine his predecessor, Jack Straw, saying the same.

Mr Blunkett, one of whose first actions was to sack the so-called drugs tsar, Keith Hellawell, seems to be aware that current policies are failing. One of the key targets in the ten-year national drug strategy is that heroin and cocaine availability should be reduced by 2008. Yet the average price of cocaine in Britain has fallen by 20% over a decade and that of heroin has fallen by up to 40%, while purity has increased.

The government's previous hard line has not persuaded Britons to cut down. More people use cannabis in Britain than in the Netherlands, which has the most liberal policies on drug use in Europe. The Netherlands also has a much lower rate of drug-related deaths—2.4 per million people, compared with Britain's 31. And whereas in Britain, the average age of heroin addicts is 25 and falling, in Amsterdam it has now risen to 36.

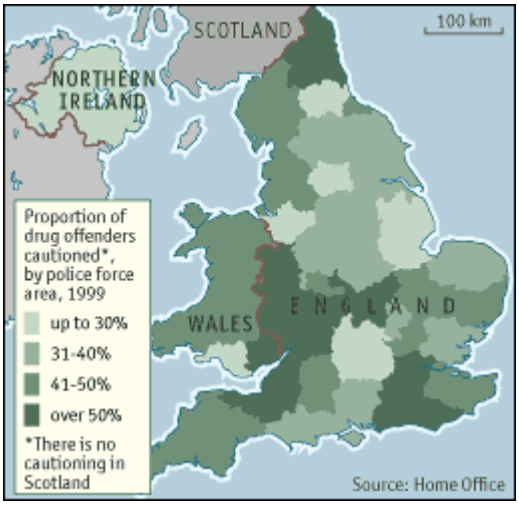
Meanwhile, the consensus that cannabis is relatively harmless grows. A report published in the *British Journal of Psychiatry* which looks at how cannabis is dealt with in the United States, the Netherlands and Australia says that it is not a gateway to hard-drug use. It also claims that decriminalisation does not increase use of cannabis. The study concludes that harsh laws against soft-drug use do far more harm than the odd puff of the weed.

Local police commanders have been left with the task of trying to enforce a law which is widely regarded as contradictory and out of touch with public opinion. More than half of all cannabis offenders are currently released with a police caution, but even that means a police record.

The current uncertainty results in huge regional variations in how the drug laws are operated (see map). More than 65% of those arrested for drug offences in London in 1999 were released with a caution compared with fewer than 18% in Durham. In Northamptonshire, 93% of people who were arrested for cannabis possession in 1997 received a caution compared to just over a

third in Dorset for the same offence.

Decriminalisation by postcode is not a sensible answer to the drugs problem. The job of the police should be to enforce the law, not to make it up as they go along.



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Advertising

No privacy in the privy

Jul 5th 2001
From The Economist print edition

Adverts are getting harder to escape

IT IS another first for British industry and design: urinals with screens. They are called “Viewrinals”, and they feature a small screen at eye level displaying adverts which, one hopes, are not too distracting. Already positioned in roughly 100 nightclubs and bars, their makers, a firm called Digital View, hope to see them adopted everywhere.

Viewrinals are just the latest (and most peculiar) example of how moving pictures are replacing conventional advertising. Screens can now be found in supermarkets, cornershops, service-station forecourts, and so on. They can either generate revenue for the shop owners or promote specific products within the store.

Liquid-crystal display technology is partly responsible for this new intrusion. The price of LCD screens has been falling, and their advantages are many. Unlike a cathode ray monitor, an LCD screen is thin—and so can fit in tight spaces and on walls. It also needs less power and is easier to protect from vandalism.

Furthermore, the Viewrinal’s screen can now be plugged straight into the Internet, and thus be fed with commercials from anywhere in the world, which are in turn transmitted with the latest video compression techniques. The Viewrinal is thus at the cutting-edge of modern technology.

Digital View has introduced advertising screens in shops, buses and trains, as well as in more unusual places. A few nightclubs now sport Digital View’s cigarette machines with built-in televisions, to advertise different parts of the venue. The company also has plans for screens in taxis and on cash registers, and for tiny ones on the side of beer pumps to promote each drink.

Will Viewrinals catch on? Advertisers can keep a tab of how many times each advert is seen. On the other hand, a loo sophisticated enough to be at risk of computer hackers is not necessarily progress. And, although Digital View also make Viewloos—screens placed tastefully by the basin—it has no plans for a female equivalent to the Viewrinal. Thank God.

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Bagehot

One little worry about Ken

Jul 5th 2001
From The Economist print edition

Kenneth Clarke's bid to lead the Tories cannot avoid a certain four-letter word

IN THE private schools where many were educated, most Conservative MPs will have taken part in a balloon debate. This will help them understand how their party intends to select its new leader in the coming weeks. From next Tuesday, and on subsequent Thursdays and Tuesdays, the Conservatives who were elected to Parliament last month will be invited to vote secretly for one of the five candidates. After each ballot, the candidate with the lowest score will be thrown out of the balloon. When two are left, their names will go to local associations, so that party members can choose between them.

This is not how Conservatives have traditionally chosen a leader. William Hague, who was elected by MPs alone, changed the rules to make them more "democratic"—meaning that he hoped in this way to make his own job more secure. Instead of that, the new rules have created an oddity in the quest for his successor. Of the five candidates, only two—Michael Portillo and Kenneth Clarke—inspire confidence in their chances of leading the Conservatives back to power. But Conservative Party members are dubious about Mr Portillo and Conservative members of Parliament are dubious about Mr Clarke. This makes it possible that the MPs will prevent Mr Clarke's name from appearing on the final ballot, and that party members will then choose whoever else ends up as the alternative to Mr Portillo. As in the case of John Major and Mr Hague, the Tories could end up with a leader whose chief virtue is who he is not, instead of who he is. Mr Clarke's supporters are especially indignant at the thought that their man, the one most ordinary party members are thought to want, might not make it to the final ballot. It seems like madness. But there is method in it.

Many of the differences between Mr Clarke and Mr Portillo boil down to style. Mr Clarke is a "bloke": a stranger to affectation who is at ease with himself, his pint, his paunch, his rumpled suit and his well-worn beliefs. If he became Conservative leader, he could offer a safe pair of hands for voters to turn to if they tire of Tony Blair's tricksy ways and Labour's unfulfilled promises on public services. Mr Portillo is a rummer cove: a bit of a dandy, a bit exotic, a bit Spanish, exquisitely aware of the impression he makes on those around him, a man who since confessing to a gay past has embarked publicly on a journey of rediscovery whose destination is not yet known. Mr Portillo cannot offer a safe pair of hands but he can claim to be interesting. He could look for new ideas, invent new issues, try to play Disraeli to Mr Blair's Gladstone. Neither approach guarantees a Conservative return to power but both are plausible.

There is, however, a problem that both men share. For different reasons, each needs to nudge the party in a direction it would prefer not to go in. Mr Portillo wants to make Conservatives more socially progressive than they feel. This makes him more popular in Parliament than he is out in the constituencies, where the average Conservative is for some reason inclined to be conservative. Mr Clarke's enthusiasm for the euro requires him to make Conservatives friendlier than they feel to the European Union. This makes him less popular among Conservative MPs, most of whom see defending Britain from the EU as the one powerful idea that still separates their party from Mr Blair's.

Euro-obsession disorder

So far, Mr Clarke has tried to solve his problem by changing the subject and urging his party to do so too. He said last week that talking obsessively about the euro was one of the things that put voters off the Conservatives in last month's general election. By this week he had followed his own advice and come up with something completely different to talk about. The something else turned out to be a plan to breathe life back into a Parliament that he accuses Mr Blair of suffocating. If he were prime minister, Mr Clarke says, he would submit himself to regular interrogation by a committee of senior backbenchers, give select committees sharper teeth, allow debates to become more topical, press for a partly elected

upper chamber, and so forth.

These are worthy ideas. But they are hardly unfamiliar to the small body of people who take a professional interest in parliamentary procedures. And although voters may not have cared much for the priority that Mr Hague gave in the last general election to “saving the pound”, they will care even less in the next one about Mr Clarke’s interesting plan to reform select committees. Mr Clarke presumably hopes that by promising more power to MPs he will persuade a few more of them to vote for him in the balloon debate. Fat chance. For all his attempts to change the subject, the unalterable fact is that Europe is the issue on which his leadership bid will stand or fall.

And rightly so. If the Conservatives were to make a kindred spirit leader of the opposition, they will make Mr Blair happier to risk an early referendum on joining the euro. This would be a pity. The economic benefits of membership still look marginal, and the EU’s constitutional future will be uncertain until the intergovernmental conference due in 2004. In the meantime, it would be good for British democracy to have an opposition that was at least mildly Eurosceptical; and it would probably be in the Conservatives’ interests too. A group of MPs who have just been elected shouting from their soapboxes about the perils of the EU, and who believed some of the things they said, may not find it profitable to perform a U-turn the morning after.

If Mr Clarke can talk them round, so be it. If he fails, it is just as well that his name cannot go to the local members who like him better: no leader who is imposed by the grassroots on his own MPs can be a successful one, no matter what a sound bloke he is. The question will then become whether Mr Portillo, supposedly the darling of the MPs, can convince the grassroots that after his personal odyssey he is still enough of a Conservative to lead their tribe. But that is a story for later.

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What a lovely odd place!

Jul 5th 2001
From The Economist print edition

Italy today is richer, better-run and a bit less corrupt than it was ten years ago, but there is plenty more to do, says Xan Smiley

THE first thing to say about Italy is that, however grubby its politics or flaky its economics, it is still, for most of its inhabitants and visitors, one of the most delightful countries in the world. Its confection of man-made and natural beauty, cultural heritage and clement climate is second to none. Its people are blessed with charm, humour and the ability to enjoy, and let others enjoy, life. Few have so brilliant a sense of style and fashion, so sumptuous a cuisine and cellar, so strong a tradition of melding hard work with pleasure. So why is Italy so troubled, as this survey will show it to be?

By the standards of the rich world, Italy's 58m people, who make up the globe's sixth-biggest economy (behind the United States, Japan, Germany, Britain and France), seem to be managing pretty well. They live longer (for an average of 78 years) than anyone else in the European Union, bar the Swedes. The bonds of family, which elsewhere in Europe are getting weaker, in Italy seem still pretty sturdy. There are fewer divorces and fewer single mothers than in most countries, and a larger proportion of children are reared in wedlock. Italians tend to own the houses they live in, and to work together as a family to earn their living. The Catholic church may play a controversial part in national life, but it still gives welcome moral guidance and solace to many. For sure, the country has its share of wretched people. But "social cohesion", in the continental phrase, remains strong, and the national mood is quite chirpy, especially if things are going well in the football stadium.

Italy excels at many things. It has some top-flight universities that have produced a clutch of Nobel prizewinners in the sciences since the second world war. The north-east of the country, between Milan and Venice, produces an astonishing range of items that sell on design, quality and marketing, from air-conditioners to jewellery and sportswear, and an array of engineering products that go into making motor vehicles, televisions and fridges.

Nor, these days, do good things happen only in the go-ahead north. Pockets of excellence can also be found in such formerly unpromising regions as Sardinia, Sicily and Apulia, not only in traditional trades such as furniture-making but also in high-tech pursuits such as microelectronics and Internet wizardry.

Exchange rates
June 22nd 2001

$1=	2,266 lire	€1=	1,936 lire
¥100=	1,822 lire	£1=	3,198 lire

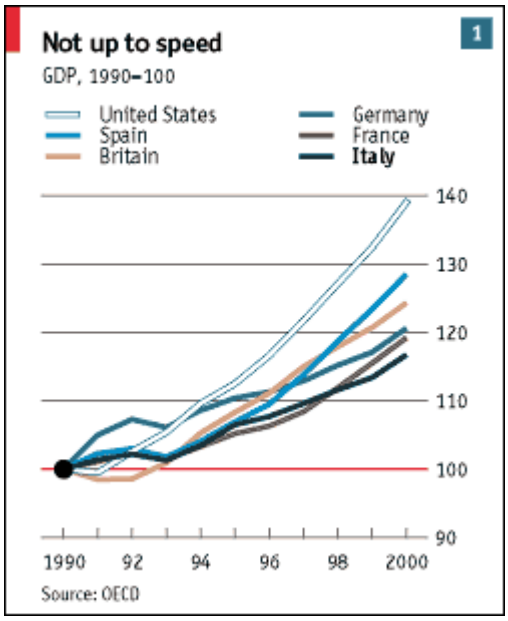
Cheering up

The economy is beginning to bounce back after some difficult years. Last year it grew by 2.9%, not much

less than Germany (3.1%) or France (3.2%). And with the lira destined to make way for the euro within seven months, Italy's treasury ministers will be under growing pressure from their European colleagues to keep their economy in trim. Certainly, Italy's entry into the euro zone has cheered just about all of its businessmen, even though they know that devaluation will no longer be an option to boost their exports when the economic going gets rough.

In many ways, Italian politics too looks in better shape after an eventful decade in which an old way of life was destroyed without a neat replacement. An odd compromise—which had allowed the Christian Democrats, in coalition with a bevy of other parties, to rule for 40-odd years after the second world war, on the understanding that they would keep out communists and fascists—was shattered in 1992-93, when much of the post-war ruling class was swept away by a slew of anti-corruption investigations and trials.

But thereafter Italy seemed to revert to its old merry-go-round of governments coming and going at the rate of about one a year. Since 1993, it has had nine, all but two of them led—a novelty, this—by the centre-left. None has been strong. In 1998, for the first time ever, the country was led by a former Communist, who gave way after a year or so to another government of the centre-left. For the past couple of years, Italy appeared to be drifting.



Hope springs eternal

The tearaway victory achieved by Silvio Berlusconi's Forza Italia and its House of Freedoms coalition in a general election on May 13th suggests that a lot of Italians want to try something new. The 64-year-old Mr Berlusconi, son of a Milanese bank clerk, is Italy's richest man. He has amply demonstrated that he is a man of action who usually gets his way. Can he do for his countrymen what he has done for himself? "*Speriamo*," say many of them: "We hope so." If he succeeds, he may even serve a full five-year term—something not a single one of his post-war predecessors has managed. At the same time, "change", "renovation" and "dynamic" are the words of expectation that come most readily to the lips of his many fans.

“I am the greatest politician in the world,” says *il Cavaliere* (the Knight), as Mr Berlusconi has been known since the state bestowed an honour on him. A few days before his election victory, he issued a set of promises. If he failed to keep them, he said, he would not stand for re-election next time. By then, he pledged, at least 1.5m new jobs would have been created. Pensioners would be guaranteed at least 1m lire ($437) a month, an increase of one-third for the poorest of them. Income tax would tumble: those earning less than 22m lire a year would pay none at all; those in the top band would pay a third less than now. Mr Berlusconi also promised to get going with a list of infrastructure projects such as motorways, fast railways and anti-flood devices. Evidently, a lot of Italians believed him.

Yet in many ways, Italy remains as much of a problem country as it was in the days when Count Metternich, Austria’s 19th-century master of European *Realpolitik*, breezily dismissed the place as a mere “geographical expression”. Since it was unified in 1861, Italy has rarely enjoyed good government. Its longest periods of stability have been deeply flawed, most blatantly under Mussolini’s fascism (1922-43) and then under the Christian Democrats that kept communists and fascists in their various new guises out of power—until the collapse of the Soviet Union, which prompted a thorough clean-out of the Augean stables in 1992.

It would good to be able to report that, ever since, the country has been bright and bouncy and squeaky clean, but it would be less than true. Still, this survey will argue that, as economic liberalisation continues apace, Italy has a fair chance of becoming noticeably richer over the next five years. However, improvements to its political system and to its standards of probity in public life are equally vital—yet much less likely.

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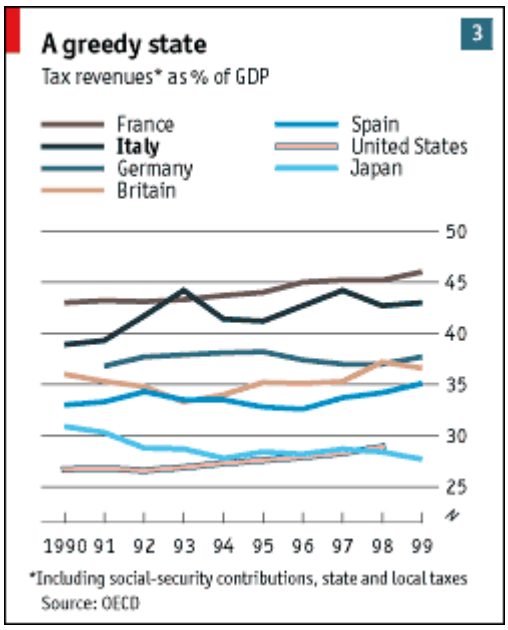
Why the gloom lingers

Jul 5th 2001
From The Economist print edition

Bad habits die hard

IT IS not as though Italy has nothing to cheer about. Budgetary discipline, thanks to the efforts forced upon it to enter the single-currency zone, has improved enormously. In the past year Italy's economy, after a half-decade in the doldrums, grew faster than Germany's and almost as fast as the EU average. The flashes of economic hope in the south, the sun-baked *Mezzogiorno*, may not be just in the pan. Moreover, the direct election of mayors and of the presidents of Italy's 20 regions has given a big fillip to local government, and spending is not as wasteful as it was.

But, viewed in the round, the picture is less rosy. Over the whole of the past decade, Italy's has been Western Europe's worst-performing economy—and it is too soon to say that the past year's upswing marks a turn for the better. Where there has been progress, it has been slow. Italy's banking system and state-owned sector are steadily opening up, but most politicians on the right as well as the left still have an instinct for interfering. The Milan stockmarket, though it has grown rapidly, is still small.



Many of Italy's giants have struggled to make their way in the more competitive and open world markets of the past decade. One example is Fiat, a huge group based in Turin, in the north-west, whose main business is motor vehicles. It once accounted for more than 5% of Italy's GDP, but its share has been dipping. Few of Italy's middle-sized companies, excellent as many are, have managed to build up the sort of muscle that would allow them to land a heavy punch abroad.

One snag is that the mix of Italy's businesses may be imperfectly suited to the new global economy. The country has also been slow to switch on to the Internet and other kinds of new technology. The European Union, by seeking to enforce competition and other rules, has been driving Italy to fight for its place in the wider market, but this is a two-way process: it also opens up Italy's markets to outsiders. Few of Italy's own giants have managed to swallow chunks of businesses in other parts of the Union.

Again, although the centre-left governments of the past six years have started to reform the labour market and liberalise the economy, other countries have done so faster. Italian governments have tinkered with the pensions system on three occasions, but have shrunk from the drastic overhaul that is needed to save Italy's greying population from old-age penury in the generation ahead. Italy's birth rate is among the lowest in the world, so unless immigrants are welcomed in much bigger numbers, the country's population could slump from 58m now to as little as 40m over the next half-century or so, making it smaller than, say, Poland's.

And the south, including Sicily and Sardinia, still seems another country—which indeed it was, until six generations or so ago. The gap between north and south in income per head may have narrowed a little, but the south is still about a third poorer. Unemployment in the north is around 5% (which amounts to almost full employment), but it is around 22% in the south, giving a misleading average of about 11% nationwide. True, some of those southern jobless may be working in the black economy but, especially for the many ill-educated young, job prospects are pretty dire. Moreover, organised crime continues to blight the south.

Perhaps the biggest waste of the past decade has been the failure of governments of all stripes to reform the constitution and the electoral system. That seems unlikely to change in a hurry: the size of Mr

Berlusconi's majority in both houses, and the seeming solidity of his coalition, have dampened talk of electoral reform. The midget parties, on the other hand, did so badly in the recent election that only a handful are represented in the new parliament. That makes a change from up to 48 parties in parliament in the 1990s.

All the same, the proportional system for choosing a quarter of the seats, which allowed so many of those midgets to get into the last parliament, is still untouched, storing up instability for a time when the balance of power between the big blocks once again becomes more delicate. Italy's electoral system remains too proportional—and no party that counts is showing much interest in dishing it.

A question of probity

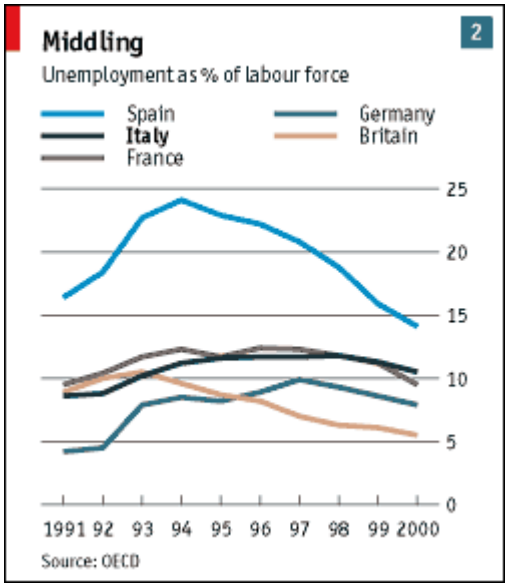
Lastly, by northern European standards, Italy is still worryingly corrupt, even though there is now a lot less corruption in high places than before 1992, and the administrations of the past six years have been pretty clean by Italian standards. But the national zest for enforcing greater honesty in public life may well have died away, and Mr Berlusconi's own dubious record of probity in business does not inspire confidence for the future.

Moreover, most experts reckon that the Mafia and the other three main criminal organisations of the south, though they took some heavy knocks in the early 1990s, have regrouped, and they have friends in Forza Italia and elsewhere in Italy's body politic. Indeed, some anti-Mafia magistrates fear that they can no longer count on the political support they have had in recent years.

Mr Berlusconi's insalubrious record in business is at odds with the image he tries to project of the new "anti-politician" standing for radical change. Quite apart from the legal entanglements which have already brought him convictions for bribery and fraud (albeit most of them set aside by statute of limitation, by amnesty and by reversals of judgment on appeal), Mr Berlusconi owns vast chunks of business in practically every sphere of Italian economic life that present him with serious conflicts of interest.

True, his crushing victory demonstrated that many, perhaps most, Italians do not care about either his conflicts of interest or his murky past. But they ought to. For one thing, corruption does not make for efficiency. Italy needs foreign investment—and gets far less than a country of its size and sophistication should expect. One big reason for would-be foreign investors' reticence is lack of trust in Italy's rickety and opaque legal system. They need reassurance if Italy is to climb back up the European league table of prosperity.

Outsiders who have watched both Spain and Italy over the years are struck by how much faster the Spaniards have progressed, economically and politically, in comparison with the Italians. Spain, with about two-thirds of Italy's population, still has a much smaller economy: barely half the size of Italy's. But a decade ago the gap was much wider still. It has narrowed appreciably as the Spanish economy has grown by an average of 2.5% since then, whereas Italy managed only 1.6%.



Corruption is quite common in Spain too, but it is far more prevalent in Italy. And even under Socialist governments, Spain has done better at loosening its labour market. It has also been more serious about devolving power to its regions, and has done more for its poor south, especially Andalusia. As an American diplomat with experience of both countries puts it: "The Spaniards are so much more serious about doing the right things." A Spanish conservationist who knows both Venice and Seville well recently described returning from Italy to the Spanish south as "like arriving in Switzerland".

Then look at Sicily—once, under 13th-century Norman rule, one of the richest and most efficiently run parts of Europe. It highlights Italy's lingering inability to make its own south anything like the north. Consider that Sicily's population is the same as Denmark's and its area not much smaller nor less abundant in natural riches. Consider, too, that in the past decade, Denmark's islands have been linked with bridges and tunnels more than 25km long, built within a few years of getting the go-ahead. By contrast, though Sicily is separated by only 3km of water from Italy's mainland, and designs and cost

calculations for a bridge have been ready for over 20 years, governments in Rome have never got past the talking stage.

In any event, Sicily still feels closer, in ambience as well as physically, to Africa than it is to Europe. And while the Mafia retains so big an influence over Sicilian politics (and indirectly quite a lot of influence over the rest of the country), can Italy yet be considered a normal part of Europe?

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They're (nearly) all centrists now

Jul 5th 2001
From The Economist print edition

Despite the rhetoric, Italian politicians these days agree about most things

Bossi fingers federalism, Fini fancies power

AS ELSEWHERE in Europe, Italy's voters and main parties of right and left have stampeded towards the centre ground. They are all for the market now. They all want to sell off the state. They all say they want to lower taxes, loosen the labour market and reform the pensions system. They all believe in "Europe". These days there are remarkably few serious doctrinal differences across Italy's political spectrum. It may seem surprising, then, that Mr Berlusconi says he is going to change the face of his country over the next five years in ways that would be inconceivable if the centre-left had stayed in power.

Listen to Walter Veltroni, the mayor of Rome (a former Communist who now admires Britain's social democratic Tony Blair), and Gianfranco Fini, leader of the right-wing National Alliance (who once revered Mussolini as one of the 20th century's greatest statesmen), and you would find it hard to tell the difference. Indeed, on some issues—such as privatisation—the post-Communists are to the right of the post-fascists. "Our ex-Communists are the most [economically] liberal party round here," says a prominent Neapolitan businessman, noting the party's zeal for (and success in) privatising such things as the local airport, against the resistance of many locals on the right. Only the Refounded (but unreconstructed) Communists on the hard left have stuck to their Marxist guns—and three years ago brought down the most effective of recent centre-left governments despite having only 5.5% of seats in parliament and 8.6% of the popular vote. Two months ago they won 5% of the vote.

For Mr Berlusconi and his friends, however, the main party on the centre-left is "the Communists"—no "ex" about it. Massimo D'Alema, its co-leader until the latest electoral setback, was often dubbed by the tycoon as "Stalinist" or "Bolshevik". The Berlusconi camp attribute *il Cavaliere's* troubles in court almost entirely to the bias of the *toghe rosse*, the "red judges" who are said to have infiltrated the judiciary on behalf of the Communists and are now wreaking their revenge on the right.

On the other hand, many on the left tend ritually to refer to Mr Fini and his Alliance as "the fascists", no "post" there either. Umberto Bossi and his Northern League federalists, who have certainly used some nasty invective against both legal and illegal immigrants, are condemned as "racist". And Mr Berlusconi is sometimes assailed by the more fervent leftists for his supposed similarities with *il Duce.* "It's back to 1922," they say, referring to the year when Mussolini came to power.

In fact, the latest election has clumped most parties and their voters more firmly than ever on the middle ground. Both the Democrats of the Left, as the former Communists now call themselves, and Forza Italia on the right, stress that the prefix "centre" must be attached to their ideological place-cards. Francesco Rutelli, the former mayor of Rome and affable centreleftist (but never Communist) who was the previous government coalition's candidate for prime minister in the May election, happily accepts that Mr Berlusconi is on the centre-right, although—as Mr Rutelli puts it—of a peculiarly populist kind. Mr D'Alema, who in the old days was a Communist apparatchik, acknowledges that Mr Fini is now a respectable democrat.

The left moves right

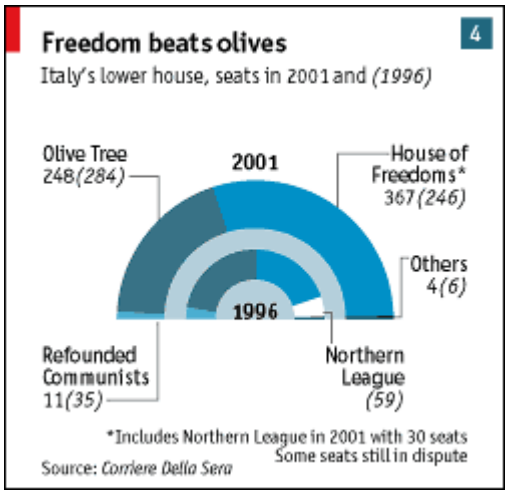
There has certainly been a sea-change on the left in the past half-decade. First there was the salutary shock, in 1994, of Mr Berlusconi having invented his party out of virtually nothing and winning a general election only a few months later; no matter that his coalition proved unmanageable and that he was out

within eight months. Then came a year of technocratic government, led by Lamberto Dini, a central banker who later became foreign minister for the centre-left. But the real turning-point came when the forces of the broad left and many of those in the dead centre rallied round Romano Prodi and, in 1996, gave the centre-left victory in a general election.

Mr Prodi was very much a man of the reforming middle, a professorial former boss of a vast state holding company who realised that Italy must overhaul its economy drastically if it was to keep up in the world rankings. He hailed from a small party close to the reforming wing of the Christian Democrats. He believed in the market. He was also pretty clean, and acknowledged that if Italy wanted to be taken seriously by its fellow Europeans it would have to become a lot less corrupt. And he knew that if Italy were to get into Europe's single-currency zone, he would have to impose strict budget discipline.

To begin with, quite a lot went right. Against the odds, the centre-left did get Italy accepted into the ranks of the euro zone. And over the past five years it has steadily sold off state assets, let some dud banks die or be bought out, cut a fair bit of red tape, loosened the labour market a little, and begun to alter the pensions system. But it did not go far enough, and it was constantly undermined by an electoral system which allowed more than 40 minnow parties in parliament to wield disproportionate influence.

Mr Prodi managed to become the second-longest-serving prime minister since the second world war, but was knocked over after two years, partly by the obduracy of the Refounded Communists and partly by the ambition of Mr D'Alema, who could not resist the chance to become Italy's first ever former Communist prime minister. He in turn was overthrown after faring poorly in regional elections and in a national referendum. His successor, Giuliano Amato, an able Socialist of the pro-market centre, found himself marking time during his year-long prime ministership, and was deemed too boffinish to stand against Mr Berlusconi in a general election.



Hence the choice of Mr Rutelli, a youngish (47), handsome, fairly successful mayor of Rome who had previously been a member of the Green party and the Radicals, a free-market party of the centre. Mr Rutelli performed as well as could be expected, but the centre-left, with four administrations to its name in five years, came across as disunited and lacking in leadership.

Now the centre-left is made up of two main parts: the Democrats of the Left, and the Margherita, or Daisy, a group of four centre-minded parties to which Mr Rutelli belongs, and which confusingly includes the plain Democrats, a party Mr Prodi helped found. It was a shock to the former Communists of the Democrats of the Left that the Daisy got 14% in the recent election, only just behind their own 16%. All in all, the left looks a bit of a mess.

The right turns solid

Conversely, one reason why Mr Berlusconi did so well is that the right these days looks much more cohesive. Back in 1994, when his Forza Italia leapt into the vacuum left behind by the disgraced Christian Democrats and led a governing coalition for barely eight months, Mr Berlusconi was hobbled by his alliance with Mr Fini's and Mr Bossi's groupings; indeed, it was the obstreperous Mr Bossi who caused the government to fall.

This time, with a simple platform of lower taxes and higher spending on infrastructure, plus some churchy and family values thrown in, the rightish coalition looks a lot more secure. The Northern League's Mr Bossi did badly at the polls, scoring less than the 4% nationwide minimum required for getting seats on the proportional lists, so he has much less potential for rocking the boat: Messrs Berlusconi and Fini could probably govern without him. But Mr Bossi will want to stay on board, to make sure that the further devolution of powers to the regions promised by Mr Berlusconi materialises.

Mr Bossi is the wackiest figure in the coalition. A former rock singer, salesman and laboratory technician, he rants on in a gravelly voice about outlandish things. He is extravagantly xenophobic, accusing Muslims of wanting to "build mosques in Padania", his would-be new country in northern Italy. Unusually for

A former rock singer, salesman and laboratory

an Italian, he excoriates the European Union for being a nest of “freemasons and Communist bankers”, among other things. He has expressed fondness for Jörg Haider, the controversial Austrian right-winger whose heartland lies across Italy’s mountainous north-eastern border.

technician, Mr Bossi is the wackiest figure in the coalition

More seriously, Mr Bossi looks forward to a Europe of some 50 regions, including Padania, Catalonia, Bavaria and Wales. But for the moment he no longer seems to demand outright independence for the north. His feeble showing at the election was due mainly to the rival attractions of another northerner to whom many northern federalists switched their support: Mr Berlusconi. If Forza Italia should falter, Mr Bossi’s party could yet come back into its own. After all, it took 10% of the nationwide vote in the general election of 1996. It has taken a knock, but it is not finished yet.

Mr Fini, who comes from a middle-class and left-leaning background, is a much more sophisticated operator. These days he is the total opposite of a rabble-rouser. He describes his party as being plain “right”, but distances it strenuously from its blackshirt antecedents: “No party these days has ideological ancestors, except perhaps the Refounded Communists.” But for all that Mr Fini dismisses the past as irrelevant, he still has a solid core of voters who hark back to the days of fascism. Mussolini’s granddaughter Alessandra is the National Alliance member of parliament for Naples, under the umbrella of Mr Berlusconi’s coalition. Like most other post-fascists, she explains that *il Duce* did an excellent job running Italy until he unwisely let himself be bullied by Hitler into joining the war.

At one point in 1994, Mr Fini topped the opinion polls nationwide. Since then, he has kept up a steady party rating of around 12%—the figure it scored in May’s general election. Last year, post-fascists won the presidency of several regions, including Lazio (the region around Rome), Apulia and Calabria. They are certainly in the mainstream of Italian politics, and they have plenty of support among civil servants and public-sector workers, especially in the south.

Might Mr Fini’s lot eventually merge with Forza Italia? Mr Fini will not be drawn on that one, but he won’t rule it out either. In any event, if the two main parties on the right can stick together, they make a pretty sturdy block of at least a third of the voters.

Give bipolarity a go

So, for the first time at least since the second world war, two solid-looking blocks have emerged in Italian politics. A lot of minnow parties are likely to fold. Others, like Giorgio La Malfa’s Republicans, may have to join Forza Italia. Fausto Bertinotti’s old unreformed Communists are hanging on gamely. But it is a pity that two worthy politicians noted for their moral fibre, Antonio Di Pietro and Emma Bonino, have been squeezed out of parliament.

Mr Di Pietro was the leading Milanese investigating magistrate who was as responsible as any, in 1992, for lancing the corruption that had rotted the Italian political system. His Italy of Values party was supposed to keep the anti-corruption flame burning. Mrs Bonino’s Radicals are the nearest thing in Italy to a libertarian party that fights for both market reform and civil rights. She was a good European commissioner in Brussels and a feisty MP in Rome. “The trouble is,” says one Florentine observer, “we have no serious respectable party on the right any more.”

As for the trend towards bipolarity, that is broadly welcome. But the system that can give small parties undue weight—indeed the power to hobble, make or break governments—is still in place. It is only the unusually large majority of Mr Berlusconi’s coalition that has given the new parliament a greater semblance of two-party politics. The move to the centre may be a good thing. But the underlying electoral system is not.

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The triumph of populism

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From The Economist print edition

How Silvio Berlusconi secured a convincing majority for the centre-right

THERE are two Berlusconis and two Forza Italias. If you can guess correctly which will come out on top, you will have a fair idea where Italy is going in the next few years.

The player-manager scores again

The good Berlusconi is the can-do businessman who wants to cut red tape, lower taxes, spur economic growth to pay for his grand infrastructure projects, and send Italy whooshing into the ranks of the most dynamic countries in the world. This Berlusconi has been unfairly persecuted by left-wing judges who, however, have never been able to nail him in a final court of appeal. The good Forza Italia is a youthful, unstuffy liberal party which wants everyone to have a chance of getting as rich as its leader, while ensuring that a safety net will still be there for the poor.

For all his ambiguities, there is no doubt that Mr Berlusconi is a remarkable man. He has vision, guts, stamina and charm. He is loyal to his friends come rain or sun, and inspires fierce loyalty among them in return. The man who accompanied him on the piano when Mr Berlusconi was a cruise-ship crooner 30-plus years ago, Fedele Confalonieri, is now the head of Mediaset, Mr Berlusconi's television company.

Il Cavaliere is brilliant at spotting opportunities. His first big break was to build an American-style garden suburb, known as Milano 2, on the edge of Italy's northern capital. His next big success was in breaking the state's monopoly of network television, ingeniously getting round the rules that blocked the creation of a privately owned television network by persuading a swathe of mini-stations to play the same programmes at the same time. Eventually parliament gave him a licence to broadcast nationwide on one channel.

Next, he realised that Italians have an almost insatiable appetite for watching television quiz shows featuring pretty girls—and that advertisers have an equally strong appetite for buying air time during such programmes. Other popular offerings provided by Mr Berlusconi were football and films, many of them American. Soon Mr Berlusconi owned three channels, which made him an immense fortune (by some estimates, he is worth around $14 billion), as well as obliging the state's TV channels to slide rapidly downmarket if they wanted to match his audience ratings.

Mr Berlusconi soon began buying up or creating a huge variety of businesses, from financial services and insurance to publishing, advertising agencies, cinemas, music, video rentals, supermarkets, football, property and the Internet. He owns the copyright on a quarter of all Italian books. He sells a third of the country's books and magazines. And most strikingly, now that he will have the main say in appointing the top people to run the three state TV channels, he will have some control over 90% of all TV broadcasting.

Join my team

Even now that it is in government, Mr Berlusconi's party, Forza Italia, feels rather like a cross between a football club and an advertising agency. The mood in its offices is cheery, slick, businesslike. Most of the people seem to be young. As a former Forza Italia senator who previously worked for Mr Berlusconi's advertising company blithely put it: "We saw a market niche and decided to fill it."

Like many Italians, Mr Berlusconi adores football. He owns AC Milan, and has won some glittering prizes with it. He has used the know-how of those who run AC's network of fan clubs across the country,

applying it to focus groups of would-be voters. Forza Italia's name comes from the words Italians use to cheer on their national football team, known as *gli Azzurri*,the Blues—just what Mr Berlusconi likes to call his own political team. He sees himself as the player-manager.

Many of his team have come straight out of the various branches of his commercial empire. In his previous government, his own lawyer, Cesare Previti, became defence minister. Marcello Dell'Utri, a former chief executive of Publitalia, the advertising wing of Mediaset, his television company, was his campaign manager in 1994 and is now a senator. The regional presidents of Piedmont and Veneto, two of Italy's richest regions, are Berlusconi advertising men. And sometimes even foes turn into allies: the leader of a tax-police unit once sent to investigate his affairs is now another Forza Italia MP.

Many of his team have come straight out of the various branches of his commercial empire

With his own advertising instincts, Mr Berlusconi places huge weight on opinion polls. Very often, say people who have worked closely with him, the polls come first, the policies after. "He's really the opposite of ideological," says one of his top TV bosses. "But he knows what's in people's heads. He just absorbs the latest ideas from outside like a sponge."

In the election he has recently won, his party manifesto was proclaimed—on the Internet—barely a week before polling day. He remained unabashedly vague about how he was going to cut taxes while hugely boosting infrastructure spending. He also carefully avoided TV interviews that might probe too deeply or try to trip him up.

Instead, he appeals directly to such crucial admirers as Italy's 8m self-employed. He goes down well with Confindustria, the confederation of Italian business, but also with the Federation of Housewives. His main constituents are former Christian Democrats whose old party collapsed in 1993. He plays hard for the approval of the Vatican, portraying himself as a family man (albeit with a divorce behind him, and children by both wives).

But his supporters come from a wide range of social and political backgrounds. He has won over people who have usually voted for the traditional left. His first friends in politics were Bettino Craxi's Socialists, not a very puritan lot. The Republican Party has come over to his side, after backing the centre-left in 1996. One of his leading ideologues, Giuliano Ferrara, was once a Communist.

Moreover, this time round Mr Berlusconi's team looks much better qualified than before. Giulio Tremonti, the new treasury minister, is generally respected. The foreign minister, Renato Ruggiero, had a good reputation as the boss of the World Trade Organisation. The man entrusted with revamping pensions, Vito Tanzi, is an acknowledged expert in the field, and was head of fiscal affairs in the IMF. Eight years after its creation, Forza Italia has become much more solid—a real party as well as a fan-club.

Mr Berlusconi oozes confidence, likening himself—only half in jest—to a new Napoleon. He believes in *decisionismo*, the smack of firm government. He admires Margaret Thatcher. He is persuasive on television, even if he goes on a bit. He has the common touch. The man, surely, to give Italy a new start?

Yet there is another, much less attractive, view of Silvio Berlusconi, and of Forza Italia. His critics depict him as a crooked fixer of the old Italian school who has little love of a truly free market and little sense of the world outside, speaking only Italian and a smattering of French. They say he set up Forza Italia to give himself parliamentary immunity and a vehicle for self-aggrandisement. In this version, Forza Italia, far from being genuinely liberal, could become a machine for patronage, corruption and interference in business, just as the Christian Democrats were before.

Electronic persuader

Indeed, say his detractors, Mr Berlusconi has more than a whiff of a *Duce* about him. He is certainly the be-all-and-end-all of his party: without him, it would be nothing. Indro Montanelli, one of Italy's most independent-minded commentators, accuses Mr Berlusconi of badgering the Italian people from "an electronic balcony"—a reference to Mussolini's famous habit of haranguing the crowds from the balcony of his palazzo in Rome. Even some who know Mr Berlusconi well say he has no real concept of conflicting interests: he simply assumes that what is good for his own businesses is good for Italy.

The Economist's own investigation of Mr Berlusconi's financial dealings, published on April 28th, found

that Italy's prime minister still faces at least five sets of criminal proceedings, having been charged, among other things, with false accounting, tax fraud, and bribing judges, the tax police and politicians. In the four cases that have so far been decided or are going to final appeal, he has been found guilty in three, acquitted on appeal in one, and acquitted on one of four counts in another. However, thanks to the exceptionally slow process of the law in Italy, he has also been saved thrice by the statute of limitation and once by an amnesty. Criminal proceedings and investigations in at least five other cases are still under way. Mr Berlusconi is likely, too, to be called to testify in the current trial for association with the Mafia of his close friend Mr Dell'Utri, a Sicilian who is still a senator for Forza Italia.

More worldly admirers of Mr Berlusconi tend to defend him on the ground that "everyone had to" fiddle accounts, and bribe taxmen and the tax police, in order to get ahead in a system where corruption was the norm. And indeed many did—but not all. "You must understand that Italy is an anomaly," is a constant refrain suggesting that corruption has been (is?) a way of life and that Mr Berlusconi should not be singled out for vilification.

The other standard defence of Mr Berlusconi is that the judges and investigating magistrates have been biased against him because they are all left-wing. "It's obvious," says Gianni De Michelis, a former Socialist foreign minister who now backs him (and who was himself humiliated in the *Tangentopoli*—"Bribesville"—scandal of the early 1990s). "As soon as he went into politics, they started hundreds of investigations into him—for the previous 20 years, zero."

It is true that Italy's entire judicial system is a mess. Above all, justice takes far too long—and rich defendants with good lawyers can drag out cases almost interminably in the hope, fulfilled several times in Mr Berlusconi's cases, that a statute of limitation will save them in the end. It is also true that some judges have a political agenda. The most influential body that oversees the working of the courts, the *Consiglio Superiore della Magistratura*, or Supreme Council of the Judiciary, does contain a political element: it consists of Italy's president, the president of the Court of Cassation (the nearest thing to a Supreme Court), the procurator-general, ten cross-party members of parliament, and 20 judges and magistrates elected from among themselves. But to become a judge or magistrate, candidates have to pass a series of rigorous tests; so far, no one has suggested that they too are rigged.

Further, it is true, as Forza Italia points out, that it is too easy to open cases. Any accusation of criminal behaviour must by law be looked into, though there are penalties for deliberately making false allegations. But a judge has to get the go-ahead from another judge, and if there is little or no chance of a conviction he is directed not to persevere with it. When a case comes to trial, the verdict is returned by three judges, though murder and some other serious crimes are decided by jury.

Accusations of bias go back only to the early 1990s, when the *Tangentopoli* scandals began to be exposed. Most (but by no means all) of those in the dock in the corruption cases were on the right. It was natural that prosecutors who sought to expose them were accused of political bias against them. In fact, many of those who sought to expose them, including Mr Di Pietro and several of the best-known anti-Mafia prosecutors, were far from left-wing, but rather what one seasoned observer calls "liberal in the Anglo-Saxon sense".

The worrying thing about Mr Berlusconi is that many Italians clearly believe him to be bent but don't care, and that many others seem to think that the judges are systematically doing him down. Either way, that casts a dismal light on standards of probity in Italian public life.

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Better, but not best

Jul 5th 2001
From The Economist print edition

Italy's economy is improving, but not as quickly as other countries'

OVER the past decade, Italy's economy has grown at an average of 1.6% a year, more slowly than any other in the European Union. Unemployment, at around 10% of the labour force, is worse than anywhere else in the EU bar Spain, whose jobless rate has been coming down a lot faster than Italy's. Inflation, at 2.8%, is also higher than the EU average. Back in 1987, Italy jubilated at *il sorpasso*, when its GDP was said to have overtaken Britain's, albeit thanks to a higher estimate of the black economy. Now Britain's economy, with a population roughly the same size, is about a third bigger. Even Italy's vaunted exports have recently been flagging. And Italy has a lower proportion than most other rich countries of people of working age in jobs—53%, against 63% in the euro zone and 74% in the United States.

The fat of the land

Perhaps the most worrying feature of Italy's economy is its relative dearth of investment from abroad. In 1999, for instance, Britain's inward flow of FDI was nine times bigger than Italy's. The gap has since narrowed, but is still huge. A recent Harvard Business School report suggests that foreigners consider Italy a closed country, lacking flexibility, capital and infrastructure—and blighted by corruption. One of the people it quotes is the head of IBM in Italy, who puts the problem down partly to the country's business culture: Italians, he says, still see foreign investment as a threat to the existing system.

The OECD marks Italy down as the least transparent of the G7 group of rich countries in its business practices. Transparency International, an independent German-based lobby that campaigns against corruption worldwide, puts Italy bottom, with Greece, among West European countries in its corruption index; in global ranking, it comes below such countries as Botswana and Estonia.

The Harvard report also points to the incestuous network of banks and big companies and families that have conspired, through a complex system of cross-holding and secretive arrangements, to maintain control over a huge chunk of the economy. They often use so-called *scatole cinesi* ("Chinese boxes"), or nested stakes, to rule their empires without tying up too much capital.

Milan's so-called *salotto buono* ("good drawing-room"), made up of business families such as the Agnellis, the Pirellis (tyres and much else) and the De Benedettis (industry and media), still tightly protects this fraternity, which since the second world war has tended to act in concert with the government of the day.

Not only has this system been bad for business, it has also fossilised the business leadership. Enrico Cuccia, who helped found Mediobanca, until recently Italy's most influential bank, masterminded the system almost until he died last year at the age of 92. Until recently, shareholder value—for those minority investors outside the *salotto buono*—was a rare phrase. Giuliano Amato, the economist who led the most recent centre-left government, agrees that Italians are "still loyal to the old system of a small group of shareholders close to management, and very wary of anyone else who might come into the company...Our culture of governance is still an elitist one, of closed companies and nearly closed shops."

But as the European Union has forced all its member countries to open up their economies, this closed system has begun to unravel, exposing Italian banks and companies to the chill wind of real competition. In this global climate, most of Italy's banks and businesses appear fairly puny. Few of the companies that have excelled either in the domestic market or as exporters have built up the critical mass needed to develop into world heavyweights. Of the companies in the *Wall Street Journal*'s latest index of the 500

biggest companies in Europe, only 35 are Italian, against 132 British, 87 German and 79 French. The Milanese stockmarket, itself privatised in 1997, is still tiny compared with those in London, Frankfurt and Paris.

Many of Italy's big companies have, in any event, been having a hard time. Most notably, Fiat, the biggest of them all, is struggling to find a new strategy. A few years ago its long-time chief shareholder and honorary life chairman, Gianni Agnelli, mused that it was "too big perhaps for Italy, but too small for the world". With a fairly new chairman, Paolo Fresco, schooled by General Electric in America, and a chief executive, Paolo Cantarella, who knows Fiat must go global, it seems to be looking across the Atlantic. Last year it let GM buy a 20% stake. Car-industry watchers wonder whether this symbol of Italian industrial muscle will remain under Italian control.

Even privatisation, which started only in the early 1990s, has often been a half-cock affair. To many of the country's economic managers, it was simply a way of raising cash while still keeping control. Even now, the Italian Treasury retains large shareholdings in ENI, an oil and gas giant (around one-third of which remains in state hands), Enel, an electricity behemoth (two-thirds), Finmeccanica (engineering, more than one-third) and Alitalia (the state airline, more than half).

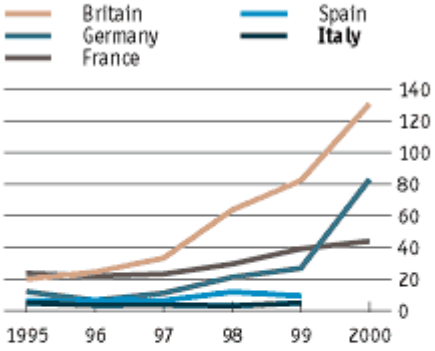
Italian entrepreneurs moan about high taxes, high social costs, red tape and a sticky labour market, and they certainly have a point. Italy's income and corporate tax rates have been among the highest in the EU, although the overall tax take as a proportion of GDP is only middling. Moreover, the tax system is exceptionally complicated. Getting the right bits of paper to start up a new company takes far longer than it does in most other EU countries. Social costs that employers must add on to wages are also among the highest in Europe. And Italians are famous for bypassing the taxman altogether: a good fifth of the tax due, it is generally reckoned, remains uncollected.

The labour market is exceptionally inflexible. "It's a lot harder to get rid of a bad worker than to divorce your husband," says a dynamic young manufacturer and newspaper owner in the south. The governments of the centre-left tried to loosen things up by promoting short-term contracts and part-time work, but were held back by their allies in the trade unions; at last count Italy had the second-smallest proportion of part-time workers (12%), and one of the smallest for workers on fixed-term contracts. The unions still insist on nationwide wage deals in various sectors.

Another oddity, given the level of unemployment, is that vigorous companies, especially up north, are finding it hard to get labour. In the 1950s and 1960s, some 2m southern Italians headed there to work in the factories of Turin and Milan. Now they are staying put. The young prefer to live cheaply with their parents and scratch around in the black economy.

And still they don't come 5

Foreign direct investment inflows, $bn



Europe's top companies, end of fiscal 2000

Country	Number	Market capitalisation, $bn
Britain	132	1,940
Germany	87	855
France	79	1,117
Italy	35	447
Spain	20	305

Sources: UNCTAD; EIU; *Wall Street Journal Europe 500*

So where's the good news?

Yet the gloom can be overdone. Italy's difficulties are not unlike those faced by the countries of Central Europe after the fall of the Berlin Wall. The country is still reeling from the collapse of its corrupt political old guard and the wrenching open of a once protected economy in the early 1990s, but it is now heading in the right direction.

For one thing, the companies that make up the backbone of the economy, the small and middle-sized ones, most of them in central and northern Italy, are remarkably buoyant. Visit the area around Vicenza, in the north-east, which has an array of small family companies, or look at ceramics companies in the cluster around Sassuolo, in the centre of Italy, and you will be struck by the energy and skills on display. These companies are flexible, quick to switch designs and marketing patterns to meet the demands of changing fashions around the world. Most of them are family firms enjoying the high morale and loyalty

that such outfits tend to inspire. And the way many of them cluster together helps them to share distribution and marketing. For instance, Treviso province, home to the Benetton clothing empire (among others), has only about 770,000 people, yet its exports earn more than those of the whole of Italy's south.

It is thanks to companies like these that Italy still exports more food-processing machines, washing machines, fridges, shoes and shoe-making machines, ski boots, ceramic tiles, jewels, woollen and silk clothes, radiators and boilers, optical frames and neck-ties than any other country in the world. Italy has many fine engineers. Even in making machine-tools, it defers only to the United States, Japan and Germany, and engineering graduates from Turin and Milan are world-class.

Another sign of vitality is the alacrity with which many Italian firms, especially in the north-east, have invested in Central Europe. The city of Trieste, for example, a mere 45-minute drive from Slovenia's capital, Ljubljana, is making a comeback as a launch-pad for doing business in the former communist world. Indeed, as the EU expands, Italy's north-east, and cities such as Trieste and Verona, are poised to profit from their geographical and historical ties with their newly accessible neighbours. Trieste sees itself as a link between Italy and the old Austro-Hungarian empire reinvented. Its businessmen hope that, within a few years, a motorway will link it with Budapest, Hungary's capital, and perhaps even with Kiev, Ukraine's.

To make up for the labour shortages in Italy's north, many thousand of immigrants from Central Europe and the Balkans are flowing in, legally and illegally. Some 8% of the workforce in and around Vicenza, for instance, consists of foreigners. Mr Bossi's lot and some of Mr Berlusconi's cruder fans resent their presence; certainly the new government seems likely to get tougher on illegal immigrants.

Italy's banks and bigger companies know they have to adapt too. "Italy has advanced, though very slowly," says Umberto Agnelli, Gianni's younger brother, who heads the family's IFI/IFIL investment companies. "It is meeting the challenge of the euro, people are being made to pay taxes, we're becoming more flexible, privatisation is going ahead. There's a new confidence." Italy's industrialists appreciate that, now that the lira is about to be absorbed into the euro, the old trick of getting the government to devalue the currency from time to time to keep exports competitive is no longer feasible.

Banks, too, realise that the rules of the game have changed. In the past three years, they have begun to consolidate. The big three (IntesaBci, UniCredito Italiano and Sanpaolo Imi), all of them hugely increased in size thanks to mergers and acquisitions in recent years, have begun to post large increases in their return on equity. Mediobanca's old influence is waning fast, as the world's big investment banks have homed in on Milan. The notion of minority shareholders' rights is becoming more widely understood; bankers are realising that they need those shareholders' backing to do the deals they want on world markets. In the past couple of years, Italian companies have become much more likely to produce quarterly earnings reports, set up investor-relations departments, put genuinely independent directors on their boards, release information in English, and make sales pitches abroad.

Pirelli's boss, Marco Tronchetti Provera, 53, though very much from the *salotto buono* himself, is typical of the new breed of Italian managers who promote the need for opening up. Other big companies, such as Italy's biggest insurer, Assicurazioni Generali, are becoming much more assertive, seeking alliances in countries such as Germany, and selling their wares much more keenly across the continent.

Most entrepreneurs of all sizes, while moaning about Italy's high tax rates and welfare and labour problems, acknowledge that the centre-left governments of the past six years, especially Mr Prodi's, did take big steps towards liberalisation, though they failed to get this across in the election. "The left did a fair job," says Mr Tronchetti Provera. "There is not a huge difference between left and right [on economic policy]," says Fiat's Mr Cantarella— except in relations with the trade unions.

Sergio Cofferati, head of Italy's biggest trade-union federation, is not dead set against part-time work and short-term contracts. Some 80% of new hirings, he says, are on short contracts. He also recognises the need for pension reform. It is not impossible that he will agree to co-operate with Mr Berlusconi to reform welfare. Indeed, that will be a big test for both men.

Mr Berlusconi will find that some of the groundwork has already been done for him. One of the most important reforms of the past half-decade was brought in by Franco Bassanini, minister for public administration (ie, red tape) in the outgone government, who drastically reduced the number of pieces of paper needed to get a job or start up a firm. In the old days, just opening a bank account or applying for a job often required producing at least nine different documents, including your residential record, your

citizenship, your “family certificate” and your birth certificate. Italians joke grimly that you still have to spend a lot of time proving to bureaucrats that you exist. The scope for bureaucratic delay (especially to make life hard for foreigners wanting to do business) and bribery was vast. Mr Bassanini’s reforms have made a huge difference.

Another useful reformer has been Pierluigi Bersani, minister for industry in one of the centre-left governments, who drastically liberalised the hours that shops were able to stay open. Other bureaucratic changes have made tax-collection much easier; according to the Treasury, this produced a large increase in revenue last year. The introduction of “one-stop shops” for getting all the right paperwork and permissions together, said to be in place in nearly half of Italy’s cities, is supposed to help companies wanting to set up new outlets or factories. The big hope is that, taken together, such changes will persuade many more Italians to move out of the black economy and into the official one.

Waiting for the Berlusconi effect

“At the moment we have a real window of opportunity before us,” says Antonio D’Amato, a successful Neapolitan packaging entrepreneur who epitomises a new breed of free-marketeer and now heads Confindustria, the businessmen’s club. He acknowledges the progress made by Mr Prodi and others, such as Carlo Azeglio Ciampi, a former treasury minister who is now Italy’s president, but says that the momentum for liberal change has been lost in the past three years. His hope, plainly, is that Mr Berlusconi will give it a boost; and Italian businessmen welcome the arrival of the euro as a device for maintaining Italy’s new-found budgetary discipline.

The past decade has been hard. But the old financial and industrial figures who controlled Italy’s economy in cahoots with government are on their way out, and the excellence of Italy’s middle-sized and small companies gives cause for hope. There is even a chance that Italy’s hitherto wretched south will cheer up.

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A retiring nation

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Italy has far more pensioners than it can afford

ITALY'S greying population and falling birth rate put the country on course for a debacle over its pension system. One of Italy's leading experts on pensions, Giuliano Cazzola, points to an array of figures that, unless other trends are reversed within a decade or so, will spell doom for the country's pensioners.

They won't be sitting pretty forever

Italians now get a state pension at the age of 56, or after 35 years of work, whichever comes first; this is gradually being scaled up to the age of 62, or 37 years in work, by 2006. Those who retire after fewer years in work get smaller pensions. Various governments since 1990 have tinkered with the system, but the savings will take time to come through.

At present, 60% of Italy's welfare pot is gobbled up by pensions, against an EU average of 45%. Until the new arrangements kick in, some public-sector workers can collect a pension—and will go on collecting it—after only 20 years' work. Many of them have two or more state pensions.

The number of pensioners is rising inexorably, partly because the average age of the population is being pushed up by the low birth rate, partly because people are living longer, and partly because Italians retire ridiculously early. On current trends, Professor Cazzola reckons, by 2030 some 42% of Italians will be pensioners—the highest proportion in Europe. If nothing is done, he says, the average Italian's pension package, now typically amounting to 54% of final salary and indexed for inflation, by 2050 will drop to less than 30%.

The best bet, most experts reckon, is to get more people into private pension schemes to top up their state pensions, and to raise the retirement age still further. So far, only 1.8m out of about 20m workers have joined private schemes. Yet in the run-up to the recent general election, the subject was barely mentioned.

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Arrivederci, Roma

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Decentralisation can help the south to take off

THE most hopeful news for Italy since the old order broke down in 1992 is that the parts of the country that are not run from Rome—cities and regions—are doing a lot better. Since 1993, mayors have been directly elected and given more power. Since last year, the presidents of Italy's 20 regions too have been directly elected. There is a bit more communal pride about, and a bit less *menefreghismo*—"it-doesn't-concern-me-ism". Most notably, a new breed of leaders in city halls and regional presidencies has emerged. As in national politics, ideologically there is little to choose between those on the centre-left and those on the centre-right.

AP

Bassolino says Basta! to the state

In Trieste, Ricardo Illy, a coffee magnate supported by the centre-left, has done a fine job sprucing up a rather faded city. Mr Rutelli, the opposition's failed prime-ministerial candidate in May, had previously been a goodish mayor of Rome. Gabriele Albertini, hand-picked by Mr Berlusconi, has been another effective mayor, in Milan. Like several others, he put various members of his staff, including his top city manager, on performance-related pay and fixed contracts. On the centre-left, Paolo Costa, an academic, has proved a sensible mayor of Venice. A young post-fascist, Raffaele Fitto, is doing well as president of Apulia.

Even Sicily has benefited from good mayors in its two biggest cities, and some brave anti-Mafia ones elsewhere. Leoluca Orlando, a former Christian Democrat who broke with his original party's Mafia-linked old guard in 1987, was a courageous, dynamic and above all uncorrupt city boss in Palermo until he stood down a few months ago to run (in vain) for president of the island's regional government. In Catania, once also a nest of *mafiosi*, one of Mr Berlusconi's physicians, Umberto Scapagnini, is building on the efforts of his impressive centre-left predecessor, Enzo Bianco, to bring in high-tech investment.

Regional giants

But the two biggest regional figures are probably Roberto Formigoni, president of rich Lombardy, who is close to Mr Berlusconi, and Antonio Bassolino, the ex-Communist president of poor Campania, the area around Naples, where he had been a reforming mayor from 1993 until last year. Both are formidable politicians who could yet play a big part on the national stage.

Mr Formigoni, who won 63% of the vote in his re-election last year, is a radical advocate of devolution. He is also keen to experiment with ideas such as giving tax-deductible vouchers to parents who want to send their children to church schools, and easier access, with state help, to private health provision. His prospects, however, may be knocked by the trial he is now facing for allegedly helping Mr Berlusconi's brother, Paolo, to win contracts near Milan for waste-dumps.

Mr Bassolino, a former trade unionist, put in a remarkable performance in Naples. Few big-city mayors of any political stripe managed to force through so liberal a raft of reforms. Against the opposition, ironically enough, of many on the right, he privatised the local airport, sold city bonds in the United States, disposed of many assets owned by the city, opened public contracts to truly public tenders and overhauled the city administration. He also sold the sellable bits of the Bagnoli steel works, outside Naples, a great white elephant of the days when the South was awarded a host of extravagant projects that helped nobody but crooked politicians and organised criminals.

The Cassa per il Mezzogiorno, a state money-box that dispensed huge handouts to the south, was closed down in 1993, so Mr Bassolino, now president of Campania, is looking to sources of finance such as the

EU's funds for poor regions. He knows that in a few years' time, when a clutch of East European countries may well have joined the EU, there will be little, if any, EU cash available for Italy's south.

By every standard economic measure, Italy's south is still strikingly less well off than the north. But because the purse-strings in Rome have been tightened, it can no longer depend on a large and cosseted public sector to keep its people contented. Organised crime—the Camorra in Naples and Campania, the 'Ndrangheta in Calabria, the United Sacred Crown in Apulia and the Mafia in Sicily—still deters most outside businessmen from trying to set up in the south, so the southerners are having to search for work elsewhere instead. Between the end of the second world war and 1970, some 4m southerners out of a population of 18m at the time are reckoned to have emigrated.

But since then pockets of enterprise, in clusters similar to those in the north-east, have sprung up around such places as Bari, on the Adriatic, where food-processing is doing well, and Matera, in Basilicata, where companies such Divani & Divani, an outfit that makes sofas, have created a dynamic new district. The removal of subsidies has forced more people into setting up on their own. In the past year or so, the growth gap between north and south, though still yawning, has narrowed a little.

Antonella Dodaro owns a chain of salami-making factories and a newspaper in Cosenza, in Calabria. Her father was killed in the 1980s when he refused to pay protection money. She thinks that simpler laws have been helpful to people starting up in business. "There is a new approach to work," she says, "and less political patronage. The most important thing is to stop throwing money at the south: it's a cemetery of never-completed public works."

One stunningly successful southern entrepreneur, and prototype of the hopeful new south, is Renato Soru, 44, who floated his Sardinian-based Internet company, Tiscali, on the Milan stock exchange two years ago. Since 1999, he has been buying large stakes in Internet companies in France, Belgium, Switzerland, Germany and the Czech Republic. Mr Soru believes that the new economy should help talented southerners get out from under the shadow of welfare dependency and criminal coercion. "For a big part of the new economy, south and north don't exist. What matters is if your computer connects you all right...physical assets are not as important as before." The main thing, he says, is deregulation, not privatisation, and he thinks it is happening.

Even Sicily, for centuries a byword for bad governance, violence and corruption, now offers glimmers of hope. There, too, some brave reforming mayors have managed to imbue their people with some civic pride. Palermo's Mr Orlando made valiant efforts to clean up his city and to reduce the Mafia's dominance. His Sicilian Renaissance Institute has enticed some of the world's greatest artists and singers to perform in Palermo.

Sicilicon Valley

Professor Scapagnini in Catania is now urging companies to join the high-tech cluster in the city's business zone centred on ST Microelectronics, the world's seventh-biggest chip maker. A host of other companies have also been attracted to Etna Valley, as Sicily's high-tech area is known: Alcatel, Canon, Ericsson, Nokia and Omnitel, among some 200 others.

Mr Berlusconi's own slogan for the south is "*testa, terra, turismo*" (brain, land, tourism). His new treasury minister, Mr Tremonti, is said to have high hopes for the south, but reckons that a lot of its black economy will have to become white first. And the dynamism of the south should not be overrated: many young southerners are still dependent on welfare. Most of them would rather have no job at all than a menial one. Menial jobs these days are done by immigrants from North Africa, the Balkans and farther east.

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Cosa Nostra, continued

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The Mafia is trying to regain its political influence of old

ON THE face of things, the Mafia is still in retreat. Between 1983 and 1993 several thousand people died in Mafia-related incidents in Sicily, but in the late 1980s hundreds of *mafiosi* were convicted and put behind bars. An even bigger turning point was reached in 1992, when the assassination in separate bomb blasts of the bravest and most effective anti-Mafia judges, Giovanni Falcone and Paolo Borsellino, caused such revulsion among ordinary Sicilians that the Mafia decided to keep its head down.

Are they coming back?

Moreover, in the *Tangentopoli* revelations of 1992, the links between the Mafia and the Christian Democratic elite, and not just in Sicily, were spectacularly exposed. In 1996, Giulio Andreotti, a Christian Democrat who was seven times Italy's prime minister, was tried for ordering the murder of a journalist who had sought to link him with the Mafia, and for his own alleged association with the outfit. Mr Andreotti was acquitted on both counts two years ago, but the prosecutors have appealed against the acquittal in the second Mafia case.

All leading anti-Mafia magistrates stress the links that existed—and still, to a lesser extent, exist—between the outfit (*Cosa Nostra*, or Our Thing, as it calls itself) and influential people all over Italy, especially in politics. "The Mafia kills in Palermo but invests in Milan," says a former chief prosecutor of Palermo. A leading Palermitan expert on the Mafia says that barely a decade ago it held influence over—and in many cases controlled—between 70 and 80 members of the two legislatures in Rome.

Politicians such as Mr Orlando, Palermo's former mayor, have won elections on an anti-Mafia ticket. In 1993, Salvatore ("Toto") Riina, a *mafioso* on whose cheek Mr Andreotti was accused of planting a ritual kiss, was sentenced to life in prison, after murdering—it is reckoned—at least 78 people.

Yet *Cosa Nostra*'s influence is still enormous, and may be growing again. "It is weaker than it was ten years ago, but stronger than four or five years ago," says a leading magistrate. "In certain quarters of Palermo it is back in control. People who are robbed go to the Mafia, not to the police." The national association of small business reckons that 80% of shops in Palermo and Catania still pay a *pizzo* (protection money). A document recently leaked from the investigating magistrates' department listed more than 300 police, politicians and businessmen suspected of Mafia links. The Mafia will smirk at Mr Orlando's heavy defeat in last month's race for the regional presidency.

Mr Orlando, like other enemies of the Mafia, stresses the importance of "changing cultural attitudes". He is convinced that this process is under way, and that the Mafia is losing the psychological war. Others are less sure, recalling the ambivalence once expressed by Sicily's great novelist, Leonardo Sciascia (1921-89): "It hurts when I denounce the Mafia because a residue of Mafia feeling stays inside me, as it does in any Sicilian. So in struggling against the Mafia I struggle against myself. It's like a split, a laceration."

In last May's election, for the first time ever, one group—Mr Berlusconi's coalition—won every single one of the 61 contested Sicilian seats for both the Senate and the lower house of parliament in Rome, with just a handful of seats going to the opposition for the minority chosen by proportional representation.

Mr Berlusconi wants a bridge built across the Straits of Messina, to connect the island to mainland Europe. It would be a potent symbol of good intent, even though the Mafia would doubtless get its share of the spoils. But a Roman economist dismisses the idea. "Connect the south to the rest of Italy? The whole place, from Naples down, should be shoved as far into the Mediterranean as possible."

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The missing ingredients

Jul 5th 2001
From The Economist print edition

What Italy needs to do to become an even better place

ITALY'S problems come under six main headings. To overcome them, it needs to:

•continue to liberalise its economy;

•loosen up its labour market;

•overhaul its welfare system;

•reconnect the south, not with handouts but by continuing to devolve powers to the regions;

•bring in constitutional and electoral reforms that will move it towards a bipolar system to produce more stable governments; and

•clean up what is still the European Union's most corrupt country.

Network maintenance

Several of these are linked, especially the first and the last: a properly functioning market is incompatible with corruption. At least until the scandal-exposing watershed of 1992, the country had neither an open economy nor a truly open (ie, uncorrupt) political system. Everything was a *lottizzazione*, a political and therefore also an economic carve-up. Now on both scores the system is being prised open.

Mr Berlusconi can start addressing many of these problems. He may loosen the labour market and sell off the state's remaining stakes in such huge companies as ENI and Enel. He may even get rid of a whole lot more state-owned businesses and reinvest some of the proceeds, along with private money, in the grand infrastructure schemes he has already heralded, including that bridge to Sicily. He may privatise two of the three channels of RAI, the state broadcaster, and even divest himself of chunks of his own empire to resolve some of those conflicts of interest. And he may pass a bill to give the regions greater powers, including tax-raising ones, though the central government should continue to divert extra dollops of revenue to the south to alleviate its poverty.

He may, even more bravely, tackle welfare and pensions too. Mr Tremonti's team should be working flat out on radical plans to encourage people to build up private pensions. If Forza Italia can put flesh on its broad idea to get public and private providers jointly to offer an improved health service, so much the better. The same goes for tax-deduction vouchers to widen people's choice of schools.

But Italy's most pressing task is to find ways of raising standards of honesty in public life. The roots of corruption in Italy lie partly in the country's brief history as a state and in the weakness of its institutions. Italy's unification, in 1861, was a shotgun affair. Most southerners only reluctantly traded their quasi-feudal Bourbon autocracy for rule by people farther north with whom they had no affinity and little shared history. The south never quite accepted the legitimacy of national rule. This encouraged the rise of bandit groups, such as the Mafia, which interceded between people and the state, sometimes dominating both.

The post-war compromise that led to patronage and *lottizzazione* reinforced the sense that individuals, families and clans, not laws, national institutions or the writ of parliament, should be the natural purveyors of power, wealth, respect and advancement. If people owe a collective allegiance, it is to town or perhaps region rather than to country. That is one obvious reason for Italy's Europhilia: for most Italians, shifting allegiance from Rome to Brussels is no great emotional wrench.

Many businessmen, especially younger ones, loathe the country's reputation for sleaze, want to do something about it, and try hard to avoid palm-greasing and political patronage. But too many Italians still think the law is something to be got round or ignored, that people who pay all their taxes are fools, that bribery is a normal way of life. "We have a different way of doing things," is a commonly heard refrain. Besides, many argue, Italy is not so odd: Germany, France and Britain have all recently had sleaze scandals.

Yet Italian corruption has been on quite another scale. For example, Duilio Poggiolini, then head of the health ministry's pharmaceuticals department, was discovered in 1992 to have salted away no less than $130m in bribes. Sergio Cusani, a once-lauded businessman, dished out some $90m to grease the palms of people such as Mr Craxi. Magistrates in the early 1990s issued 619 requests to lift immunity on members of parliament, of whom 319 were investigated for corruption. Of the 2,500 or so top people investigated in that period, more than 500 were convicted.

Sadly, less than a decade later, popular indignation has waned. Big businessmen found guilty back in the early 1990s of such crimes as tax fraud and bribing politicians still chair leading companies—unthinkable elsewhere in the EU. Numerous supposedly shamed politicians, including Mr Andreotti, were still on the hustings (or at least on party lists) last May, many of them winning seats. Lots of people think Mr Berlusconi "only did what everyone else did".

Invisible networks

Patronage still drives politics and public life. In the old system of *lottizzazione*, many correspondents' jobs in RAI, for instance, were dished out according to party labels; so were thousands of other public appointments. Much of this system lingers. Italy, in the words of a top Turinese economist, is "still dominated by invisible networks". If a politician approaches someone with an idea or a journalist makes an inquiry, the first unspoken reaction is invariably "*Chi ti manda*? Who sent you?" If an investigation reveals a misdeed, most Italians still assume someone is "behind" the exposure. Too many Italian journalists are scratching backs—and having theirs scratched in turn. No wonder the foreign press is taken so seriously.

Despite those failings, Italy is still one of the world's most dynamic, enjoyable and in many ways admirable countries. Both in politics and in business, it is less corrupt and more open than it was. But it will not catch up with its richer rivals, or be taken entirely seriously by other countries, until it has cleaned itself up a lot more. Oddly enough, it is on that score, among others, that Mr Berlusconi will be judged.

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Airline industry

Grounded again

Jul 5th 2001
From The Economist print edition

Falling traffic, rising losses, striking pilots, failed mergers. Some everyday problems for the world's airlines

AFTER a long and comfortable period of growing by 5% a year, which was faster than GDP in all its main markets, air travel is starting to show its age. Figures for Europe and America fell by about 2% in May, year-on-year. In America, traffic has grown more slowly than GDP in eight out of the past 13 quarters. The last time the airline industry stalled, it suffered horrendously because of the combination of recession and the Gulf war, which scared away many travellers. The current crunch, like the last one, has also come at a bad time for the world's airlines. All sorts of other forces are buffeting an industry that lives on the edge of instability.

Start with poor results. This week, KLM's shares fell by 5% after it gave a warning that its first-quarter profit would be "substantially" below that of last year. In America, only Southwest Airlines and Continental stayed in profit in the first quarter of this year (admittedly, always a slack period for airlines). In Europe, Air France, Lufthansa and British Airways are all now making losses. On July 4th, BA reported a fall in traffic for the second month in a row, though the rate of decline was a little less precipitous: 8.9%, instead of May's 14.6%. In another sign of the times, United Airlines this week cut its dividend by 84% because the tough times of the first quarter carried through to the second and are eating into profits.

United's woes illustrate the wider picture of a beleaguered industry that is struggling to consolidate and to become more global. This week, the airline confirmed that it is in discussions about how to scrap its agreed takeover of US Airways, announced in May last year. This was to have been the capstone of United's strategy, making it at a stroke the biggest airline in the world and the one with the most powerful network in America. Unfortunately for the airline, the plan raised serious competition worries. For instance, the combined airlines would have had more than 50% of the market on 20 of the busiest American routes.

Faced with mounting opposition and the likelihood of being blocked by the Department of Justice, United and US Airways had no choice but to give up their grand dream. The only comfort is that they will be spared the job of integrating their operations in a downturn or recession. Nevertheless, United has to stand by and watch its arch-rival, American Airlines (AA), become the world's biggest carrier after its unchallenged acquisition of troubled TWA earlier this year.

Another merger that has gone sour is Swissair's flirtation with Belgium's Sabena, in which it has a 49.5% stake. Swissair has crushing problems of its own. Not surprisingly, it is unwilling to pour in more money unless the Belgian government contributes some, and unless there are big job cuts to stem Sabena's losses. Furious Sabena workers blocked a runway to prevent a Swissair flight from taking off from Brussels on July 3rd. Now the Belgian government says it will pursue Swissair in court for welshing on an agreement to take its stake to 85%.

Despite these failed marriages, there are signs of some more consolidation in future. Air France and Alitalia agreed at the end of June to form an operating alliance that could lead them to take equity stakes in each other. This follows Alitalia's failure to woo KLM. And BA has high hopes that it can re-launch its so-called "virtual" merger with AA, which stalled when European Union regulators raised objections.

Pilots of the world unite

On top of these various woes, the airline companies must also cope with a rash of strikes and threats of strikes, which is affecting airlines in Asia as well as in Europe and America. Pilots are particularly disgruntled. The latest wave of trouble started last summer when United's pilots won pay increases of around 24%, followed by their colleagues at Delta Air Lines. Pilots at Hong Kong's Cathay Pacific are on a go-slow; Iberia's down joysticks every other day; and Lufthansa's were doing likewise until last month when an outside mediator gave them most of the huge rise that they wanted. Lufthansa's pilots were seeking parity with their colleagues in the German airline's American alliance partner, the open-handed United.

The world's biggest airlines have flocked together in three main alliance groups, known as Star Alliance (United, Lufthansa, Singapore and ten others), Oneworld (led by BA, AA and Cathay Pacific), and Skyteam (Delta, Air France and Korean Air among others). These joint marketing arrangements have allowed airlines to boost revenues by cross-selling each other's flights. But none has really made much headway in cutting costs.

The pilots are much better organised. They have formed associations for each of the big three alliances. The Star one is called—wait for it—ASAP (Association of Star Alliance Pilots). Aptly, its members have wasted no time in getting down to the gritty business of swapping notes on pay and conditions, and comparing negotiating tactics.

Pilots had feared that the alliance airlines would draft in pilots from partners in lower-wage economies, as already happens with cabin attendants. Instead, the pilots have sought to level up to American salaries. John Lindquist of the Boston Consulting Group, the author of a new benchmarking study on alliances, reckons the airlines risk losing more money from this sort of pilot activism than they could ever recoup in back-office cost savings.

All this labour trouble comes at an awkward time for the airlines. Pilots are after a share of the fat profits that their carriers have made in recent years. The trouble is that huge pay rises are increasing costs just as the industry goes into a cyclical downturn and profits melt away. Moreover, big pay rises for pilots make humbler airline workers keen to get more than the modest rises they normally win. In the meantime they become surly because they feel they are exploited. And surly is not good in a service industry.

For some airlines, the wage rises have already become painful. Chris Tarry, aviation analyst at Commerzbank in London, has calculated that the increase of $129m in AA's labour costs in the first quarter of this year is equivalent to a massive 61% of the profit it made in the same quarter the year before, and therefore a big factor in the airline's swing into loss this year.

For years the industry's leaders thought that their salvation in an increasingly deregulated world would be consolidation, through mergers where allowed, and alliances where not. That may yet be true. But the history of alliances has been disappointing, with much partner-swapping and one whole grouping—with Swissair at its centre—falling apart a few years ago. Even when they involve cross-shareholdings, alliances can be unstable. Meanwhile, the failure of the United and Swissair initiatives suggests that full-blown mergers are a dead end for now. If there is an easy way out of the industry's current troubles, it is well hidden.

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Air travel

Moan, moan, moan

Jul 5th 2001 | BALTIMORE
From The Economist print edition

Everybody's doing it

IF YOU were among the 610m passengers who travelled by air in the United States last year, you probably have something to complain about. Record numbers of flights were delayed, cancelled or oversold. Needless to say, nothing has changed. But now you can grumble publicly.

AP

A bunch of Don Quixotes

Complaining online is particularly popular. "The airlines have spawned an industry," says Joe Brancatelli of BizTravel.com. There is now ample opportunity for disgruntled passengers to, as he says, "be your own Don Quixote". PassengerRights.com and AirTravelComplaints.com are devoted to griping about airlines. Planetfeedback.com, BitchAboutIt.com and ScrewedCentral.com also feature air travel prominently. And then there are websites launched by individual travellers with a bone to pick, such as AmericanAirlinesSucks.org. Other sites aim to cash in on complaining: TravelProblems.com offers a $30-per-claim "Complaint Management Service", which attempts to negotiate compensation for dissatisfied flyers.

Radio and television programmes increasingly chronicle passengers' horror stories. Half the stories by the travel editor on NBC's "Today Show" are based upon complaints, mostly about the airlines. Public Radio International has a "Savvy Traveller" slot, featuring complaints from the public, travel journalists and even public officials. Earlier this year, Senator Harry Reid of Nevada spoke on the programme about a bill he had introduced, the Air Travellers' Fair Treatment Act. The same week, another senator, Ron Wyden of Oregon, reintroduced his idea for a Passenger Bill Of Rights, proof that politicians see public complaints as popular issues.

All this grumbling might have more effect if it were more carefully monitored. Though thousands of complaints are lodged on various websites and through the media, they are not properly counted. The Department of Transportation, which officially records complaints against airlines, reports that they rose by 25% last year. Yet it documented a total of only 9,606 complaints.

In the end, much of the frustration vented against airlines may be more therapeutic than effective. Still, it makes for good reading. "There is almost something pornographic about travel-complaint websites," says one travel writer. "It's like the letters section of Playboy: they may not have really happened, but the stories are entertaining."

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GE / Honeywell

Engine failure

Jul 5th 2001 | PARIS
From The Economist print edition

How the Americans helped block GE's merger with Honeywell

WHEN he proudly announced the intended $42 billion merger of General Electric (GE) and Honeywell last October, Jack Welch, GE's chairman, made two serious errors of judgment. First, he underestimated the risk that regulators might balk at such a powerful combination. Ironically, it was the European Commission's antitrust team led by Mario Monti that eventually derailed the all-American transaction. On July 3rd, Mr Monti confirmed that he would not allow the deal to proceed, an outcome that had appeared increasingly likely in recent weeks.

Mr Welch's second error was to quip that it would be his "neck on the line" if he failed to pull off the merger. He postponed his retirement by eight months as a condition for winning Honeywell's approval of his last-minute trumping of a bid from United Technologies (UTC), another American electronics and engineering group. But with the merger blocked, Mr Welch can simply retire as planned. It turns out that Michael Bonsignore, Honeywell's chairman and chief executive, was really the boss in danger. After Mr Monti's announcement, Honeywell immediately replaced him with Larry Bossidy, a former GE manager and boss of Allied Signal, which Honeywell acquired in 1999.

In effect, Mr Bonsignore was punished for GE's failure to clinch the deal. But there is little doubt that Honeywell is in worse shape than if it had taken the less ambitious option of merging with UTC. Its main avionics business has suffered the double blow of slumping orders caused by economic downturn and operational difficulties exacerbated by the attention given to the merger. Mr Bossidy's first act was to issue a profits warning: Honeywell expects to miss its second-quarter forecast and is gloomy about the rest of this year. Its shares have slumped.

Honeywell could sue GE on the grounds that its suitor did not use the required "best efforts" to gain regulatory approval for the merger. But that seems unlikely. GE scrambled hard in recent weeks to win approval in Europe, but would not budge on central issues that would have undermined the economic case for the deal. On June 29th Mr Bonsignore wrote an open letter to Mr Welch offering to drop Honeywell's price to soothe some of GE's concerns. Mr Welch's response, also public, was politely withering.

Besides, GE also emerges from the debacle in a tricky position that will require careful tactics from Jeffrey Immelt, Mr Welch's successor. Mr Monti stated bluntly that GE and its aircraft-leasing arm, GECAS, already have a "dominant position" in some markets for jet engines. That finding opens the way for competitors to harry the conglomerate in future through conventional competition agencies. Even if it appeals, as it can, GE is likely to be stuck with this finding.

In ruling against the merger, Mr Monti has soured relations with America's Department of Justice, which cleared the merger in May, demanding only minimal disposals. Did American regulators do a proper job? Lawyers involved in the case say privately that Mr Monti's team was much more thorough in exploring the competitive dynamics of the aircraft and avionics markets. The European Commission was no doubt helped by the fact that, by the time its investigation was under way in March, GE/Honeywell's competitors, notably UTC and a fellow American company, Rockwell Collins, had woken up and mustered strong arguments against the deal. By then, the justice department had already made up its mind.

The European Commission's conclusions are clearly unpalatable to GE. But are they only what tough scrutiny would have revealed had it first occurred in America? Mr Monti, anxious to preserve transatlantic relations, was far too polite to ask this question in his own defence. But in the end it was mainly American companies, not Europeans, that furnished him with the information that was used to justify blocking the deal. American politicians, including President George Bush, whose harrumphs have injected

a nasty note into the proceedings, would do well to bear that in mind.

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Tobacco industry

The price is not quite right

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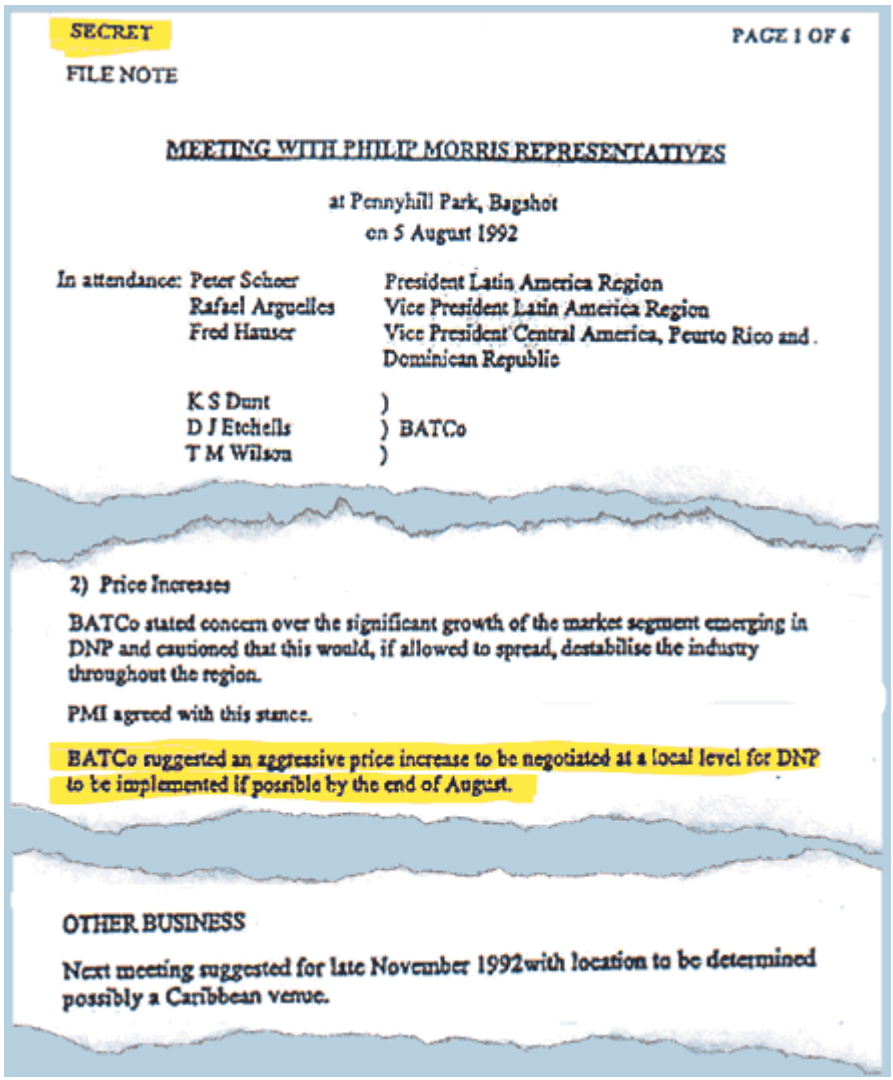
Cigarette companies have been accused of all sorts of wrongdoing. Is it time to add price-fixing to the list?



SECRET

PAGE 1 OF 6

FILE NOTE

MEETING WITH PHILIP MORRIS REPRESENTATIVES

at Pennyhill Park, Bagshot
on 5 August 1992

In attendance: Peter Scheer — President Latin America Region
Rafael Arguelles — Vice President Latin America Region
Fred Hauser — Vice President Central America, Peurto Rico and Dominican Republic

K S Dunt)
D J Etchells) BATCo
T M Wilson)

2) Price Increases

BATCo stated concern over the significant growth of the market segment emerging in DNP and cautioned that this would, if allowed to spread, destabilise the industry throughout the region.

PMI agreed with this stance.

BATCo suggested an aggressive price increase to be negotiated at a local level for DNP to be implemented if possible by the end of August.

OTHER BUSINESS

Next meeting suggested for late November 1992with location to be determined possibly a Caribbean venue.

Get article background

THE tobacco industry has plenty of fires to fight at the moment. It stands accused of supporting cigarette smuggling. It has also faced a raft of claims that it misled smokers about the dangers of cigarettes and marketed an addictive drug to teenagers. On June 29th, America's Supreme Court refused to hear an appeal brought by Brown & Williamson, a cigarette firm, opening the way for the first tobacco-related payout to a private individual.

The industry's legal woes have been compounded by the terms of out-of-court settlements. In settling with the state of Minnesota for $6.6 billion in 1998, a group of companies—including Philip Morris (PM), British American Tobacco (BAT) and R.J. Reynolds (RJR)—agreed to place company documents unearthed in the litigation into public depositories for ten years. Researchers have been sifting through these for indications of further misdemeanours, with some success: some documents, for instance, raise serious

questions about involvement in smuggling, which the firms deny. Equally important, they point to widespread price-fixing.

The Economist has seen documents that suggest the big tobacco multinationals colluded to fix prices in as many as 23 countries in Africa, Asia, the Middle East, Latin America and Europe. All of the documents come from the archive that BAT, the world's most international tobacco company, set up in Guildford, England, following the Minnesota settlement. But although they are internal BAT memos, they also suggest the involvement of its main competitors in price collusion.

Several of the documents make overt reference to price increases negotiated with rivals. An example is a memo on the Thai market, written on March 1st 1991, just after a decision by the GATT, the predecessor of the World Trade Organisation, forced the Thais to open their cigarette market to foreign firms. It says: "PM and RJR want to go in at 40 baht and continue with transit [industry jargon for smuggling] to supply demand." It goes on to explain that the rivals are advocating initial pricing at that level "to demonstrate that the legal business will be minimal". The companies, it seems, were fixing prices not only to raise their margins but for a more strategic reason: to lull the Thai government, one of the developing world's more anti-smoking administrations, into thinking that new foreign cigarette brands would not fare well, and thus avoid tobacco-control measures.

In another document from 1991, this time on Latin America, a BAT manager explains to a colleague that Philip Morris "agreed to raise Marlboro's price above BES [a BAT brand] earlier this year as part of a series of price increases to restore industry profits after the 'war' of 1989." A further memo, from 1992, concerning El Salvador, refers to local BAT managers consulting a Philip Morris executive on price increases. "We continue to negotiate with competition," it concludes.

Perhaps the most extraordinary document shows the minutes of a meeting between managers from BAT and Philip Morris at Pennyhill Park, a hotel near London, on August 5th 1992 (see illustration above). Among those present were Peter Scheer, then president of Philip Morris's Latin American operations, and Keith Dunt, a BAT executive who went on to become the company's chief financial officer. The minutes reveal that the executives discussed fixing prices in several Latin American countries, in both the legal market and the "DNP" market. DNP stands for duty not paid—ie, smuggled.

These are not isolated cases. In a 1991 document entitled Summary of Group Marketing Strategies, the third strategy on the list is to "implement regular price increases, on an industry basis wherever possible, which at least cover inflation to secure adequate profitability..."

Nor do the documents refer merely to straightforward price collusion. Market share was fixed, too. A note on BAT's Zimbabwe strategy, marked "secret", refers to the lack of profits growth in that market being in part attributable to "a 50:50 sharing agreement with Rothmans of the 2.4 billion annual market, thus discouraging any real management dynamics." Rothmans merged with BAT in 1999.

Reuters

An expensive drug

Often in cases of alleged price-fixing, the companies involved claim it was all the fault of rogue country managers far away. In this case, that is hard to argue. Although most of the documents seen by *The Economist* relate to developing countries far from head office, some of them were most likely read by senior BAT executives. The Zimbabwe document was headed "Note to TEC", a reference to the Tobacco Executive Committee, which consisted of company top brass. A number of other documents were sent or copied to senior managers at head office. In some cases, the authors were top executives at BAT's export arm, BATUKE.

Another claim made by industry sources is that it would be pointless to try to fix prices in the developing world, as in most countries the global players are up against local monopolies that dominate the market; without their co-operation, it would be impossible to keep prices artificially high or low. But this claim is spurious, too. Even in those countries where the tobacco multinationals have only a modest share of the overall cigarette market, the market can essentially be divided into two: cheap local brands, and the so-called "premium" market of international brands such as Marlboro and Camel. In this high-margin segment, two or three multinationals usually dominate—and can easily manipulate prices if they collude.

Eric LeGresley, a consultant based in Ottawa, says the documents strongly suggest that tobacco

multinationals have operated as a cartel, with price-fixing as an integral part of their operations. “Once you rationalise that your products will be killing half of your customers,” he argues, “everything else questionable that you might do must seem rather pedestrian.”

BAT declined requests for an interview about the documents. “These are old documents taken out of context,” it said. RJR said it could not answer questions about its international operations, as these were sold to Japan Tobacco in 1999. Philip Morris said the documents were not new, and that it abides by the laws of all countries in which it does business.

Leaving a trail

Taken as a whole, the documents strongly suggest that the fixing of prices and of market share was widespread in the late 1980s and early 1990s. Clearly, at that time the tobacco companies did not expect that their internal documents would end up in public archives. Even so, there were attempts to avoid leaving a paper trail. In one memo, dated March 8th 1990, a manager pleads with a colleague not to name “interested parties” and to keep communication oral whenever possible. Another document of around the same time, entitled “Low Category Pricing”, refers to a meeting with people from RJR, and advises that “we should stick to the letter of the agreement—even though it will be purely oral!” It is hard to see why agreements would have to be oral, unless they involved something questionable.

What of BAT’s dismissal of the documents as old? Certainly, they are all at least five years old. Even if they were to admit that the documents referred to actual price-fixing, the companies might argue that they have changed their ways—and there is no evidence to suggest that any such thing is still going on. If such evidence exists, it would not be found in the depositories, as they only cover the period up to 1995. It is possible that none of the price-fixing in the documents was illegal at the time—Thailand, for instance, only formally banned price-fixing in 1999—but, legal or not, it was certainly unethical.

Might the industry have cleaned up its act voluntarily? Perhaps. One thing seems clear, however. Tobacco firms have always fought tooth and nail against price rises imposed on them by governments. But price hikes fixed within the industry? That is a different matter entirely.

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Microsoft trial

A loss of trust

Jul 5th 2001 | SAN FRANCISCO
From The Economist print edition

The appeals-court ruling has not brought the Microsoft antitrust case any closer to a conclusion. It could even turn the firm into a regulated monopoly of sorts

Get article background

ALL of a sudden, the prospect of closure was in the air. After America's Court of Appeals issued its long-awaited decision in the antitrust case against Microsoft on June 29th, everyone seemed a winner. Bill Gates, the company's co-founder, triumphantly declared that the ruling lifted the "cloud of the break-up". Microsoft's critics were equally jubilant that the seven judges had unanimously found that the world's largest software firm indeed holds a monopoly—and has repeatedly abused its power to protect its Windows operating system from competition.

The only clear loser was Thomas Penfield Jackson, the lower-court judge who ordered the company's break-up a year ago. As was widely expected, the appeals court removed him from the case, for conduct that had "destroyed the appearance of impartiality". At the trial's end, Judge Jackson had repeatedly attacked Microsoft in media interviews. He likened the authors of its incriminating internal e-mails, for instance, to drug traffickers who "never figure out that they shouldn't be saying certain things on the phone".

Unsurprisingly, there is now much talk of a settlement. Many observers believe the appeals-court ruling has opened a path to a compromise that will leave Microsoft intact while punishing it for its past sins and ensuring that it changes its monopolistic ways. Yet anyone hoping that Microsoft's antitrust woes are finally over is bound to be disappointed. In some ways, the appeals court's decision makes things worse: the firm could well end up as some sort of regulated monopoly that has to get its design choices approved by the courts.

Clearly, the ruling is a compromise to achieve unanimity. Deferring to Judge Jackson's "findings of fact", the court concluded that Microsoft, with Windows, does indeed hold a monopoly in operating systems for PCs powered chiefly by Intel microprocessors. Furthermore, the judges said, this is not a monopoly that is perennially in danger of being eclipsed by rapid change in the computer industry, as Microsoft has always argued.

Having reached this conclusion, the court could hardly approve of the licensing restrictions that Microsoft imposed on PC makers and Internet service providers in the mid-1990s to beat back Netscape and its web browser, then considered a threat to Windows. The judges agreed, for example, that Microsoft had abused its monopoly when it barred PC makers from removing a direct link, or "icon", for the firm's own browser from the Windows desktop. They even found some of Microsoft's "co-mingling" of code from the operating system and the browser anti-competitive, because it deters PC makers and users from installing rival browsers.

But the court sided with Microsoft on two other claims: that the firm had tried to monopolise the browser market and that it had unlawfully bundled its browser with Windows. The latter finding is perhaps the more important. Judge Jackson had applied a legal rule called "*per se* analysis". This holds that the "tying" of two products is automatically illegal because it reduces consumer choice. The appeals court ruled that, given the dynamic nature of the software industry, a different standard called "rule-of-reason" is more appropriate: each case of tying must be considered individually, taking into account any possible benefits to consumers, such as lower cost.

Yet even on this point Microsoft did not score complete victory. The appeals court has not given it carte blanche to bundle anything it likes with Windows, as it did in a 1998 decision related to the case.

Where the limits to such bundling now stand will be decided on a case-by-case basis, leaving open the question that underlies the entire case: how much bundling should Microsoft be allowed? Although it did not say so explicitly, the appeals court seems to think that packaging a browser with the operating system passes muster. But what about Windows XP? Critics and competitors of this, the latest version of Windows, due out on October 25th, call it the mother of bundled products—and one with which Microsoft hopes to make headway in three new markets at once: online multimedia, instant messaging and web services.

A settlement could provide some answers. It would probably come in two parts: one to “correct past misconduct” and another to “fence in” future behaviour. In the first, Microsoft will certainly have to accept the loss of some of its control over the desktop, meaning that it will no longer be able to dictate to PC makers exactly what the main Windows screen should look like. The firm will probably also have to promise not to co-mingle the code of the operating system with any new applications it comes up with. The second part will deal with the extent to which Microsoft can bundle new applications with Windows.

Although a settlement is the most likely outcome, it is also possible that Judge Jackson’s successor, who must be appointed shortly, will have to decide. The attorneys general of 19 states—who along with the Department of Justice are the plaintiffs in the case—have a right of veto over any agreement. All along, they have taken a more aggressive stance towards Microsoft than has the justice department. And they have already indicated that they do not plan to let it off with a mere slap on the wrist. Some see a break-up as being still on the table. They could file for an injunction blocking the release of Windows XP.

All this will take some time to sort out. Because of the complexities of the case, settlement talks could go on until the end of the year. If the lower court gets another shot, it probably will not rule before the middle of next year. And then the case will probably go back to the appeals court or the Supreme Court. That is why American antitrust experts are now looking across the Atlantic to see where the Microsoft action will be over the coming months. The European Union is conducting two similar, but distinct, investigations into whether Microsoft illegally leveraged its PC desktop monopoly into the market for server-operating systems.

To expect, however, that the European trustbusters will now do the work of their American colleagues is probably wishful thinking. The American and European cases are markedly different. And the EU may not want to make life too difficult for the icon of America’s “new economy” after having just blocked the all-American merger of GE and Honeywell.

In any event, Microsoft’s real trouble may well come from a different quarter. The appeals-court decision could also lead to more private lawsuits—from competitors such as AOL Time Warner, for example, which now owns Netscape, or Sun Microsystems.

Worse, the trial has undermined trust in Microsoft. The firm recently abandoned, at least for now, a feature in Windows XP called Smart Tags because it was widely seen as a way of using its monopoly to attract customers to its online services. The technology would have allowed the Microsoft browser to turn any word on a web page into a link to the firm’s own sites. The fears were probably overdone, but such is the price of a loss of trust.

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Montedison

Dust-up in the drawing room

Jul 5th 2001 | MILAN AND PARIS
From The Economist print edition

Fiat and EDF team up to grab a conglomerate from Mediobanca

Buying and selling

Top ten mergers and acquisitions in Italy

Target name	Acquirer name	Transaction value, $bn	Attitude
Telecom Italia	Olivetti	34.8	Hostile
Seat Pagine Gialle	Tin.it	24.8	Friendly
Banca Commerciale Italiana	Banca Intesa	12.8	Friendly
Unicredito	Credito Italiano	11.0	Friendly
INA	Assicurazioni Generali	10.2	Hostile
Istituto Mobiliare Italiano	Istituto Bancario San Paolo di Torino	9.5	Friendly
Infostrada	Mannesmann	8.4	Friendly
Infostrada	Wind Telecomunicazioni	7.7	Friendly
Mei-Microelettronica Italiano	Finmeccanica	4.8	Friendly
Montedison	Fiat, Electricité de France and others	4.2	Hostile

Source: Thomson Financial Securities Data

FEW things are as riveting as a good corporate set-to, complete with allies falling out and institutions getting thumped. Such a spectacle has been under way in Italy and came into the open on July 1st when Fiat, Italy's giant car maker, announced a hostile *euro*5 billion ($4.2 billion) bid for Montedison, a Milan-based energy, chemicals and agro-industry conglomerate. The move is the latest scrap among members of the *salotto buono* (literally, the "good drawing room"), a select club of Italian financiers and businessmen.

Fiat's deal is both opportunistic and cunning. Electricité de France (EDF), France's state-owned electricity monopoly, revealed in May that it held a 20.1% stake in Montedison. This caused a storm of protest in Italy. The government issued a decree restricting the French group's voting rights to 2%, claiming that it was unfairly trying to enter Italy's deregulated electricity market—Montedison controls Edison, a power firm, with a 61.3 % stake.

EDF's incursion was also a direct challenge to Mediobanca, until then Montedison's biggest shareholder with a 14.5% stake. For decades this small but influential investment bank has pulled the strings of Italian capitalism. Fiat and the bank own big stakes in each other.

Fiat has neatly helped EDF to sidestep its trouble. Together they have created Italenergia, a new concern in which EDF will have an 18% stake and Fiat 38.6%, making it the dominant partner in the bid. Italenergia also has financial partners. A firm controlled by Romain Zalesky, a French financier, gets 20% in return for its 10.3% stake in Montedison. And three big Italian banks have swapped their shareholdings in Montedison for Italenergia shares. Italenergia's position looks unassailable, given that it already had 52% of Montedison when it launched its bid. Mediobanca and its allies can count on around 30%.

Italenergia's strategy is simple: to break up Montedison. It will generate cash by selling off the agro-business, which accounted for *euro*9.9 billion of the group's *euro*14.3 billion of net revenues last year. The break-up will mean fat fees for investment banks. The big loser will be Mediobanca, which is said to rely on Montedison for around one-quarter of its income.

The deal is a boost for the Agnelli family, which controls Fiat. In effect, for no cash outlay Fiat will become the main shareholder in Italy's second-largest power firm. At the same time, the Agnellis have settled some scores with Mediobanca, which had increasingly snubbed them in recent years. Buying Montedison is obviously a big move away from Fiat's core business, but it need not be a distraction. EDF, which already has a joint venture with Edison, will provide the management skills for the new concern.

Whether the bid for Montedison is good for the target's other shareholders is another matter. The three banks' stakes in Montedison are valued at *euro*3.2 per share, while smaller shareholders are being offered only *euro*2.8 per share. That deference towards a lucky few at the expense of the minority might have been lifted straight from Mediobanca's much-thumbed textbook on how to do cosy deals.

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Gazprom

Dirt leaks out

Jul 5th 2001 | MOSCOW
From The Economist print edition

Curious happenings at Russia's biggest company

THAT evasions sharpen suspicions is something that managers at Russia's gas giant, Gazprom, and its mysterious Florida-based partner company, Itera, seem not to have understood. Both have long insisted that there is nothing odd about their links, which involve Gazprom showering Itera with assets and contracts.

Some newly leaked digging shows that Gazprom did indeed sell assets to Itera rather cheaply. One gas field went for just $30,000. Bill Browder, an American fund manager, reckons that a fair price would have been $500m. Even odder, 19 Gazprom managers, including three senior executives, have declined to answer questions from its auditors, PricewaterhouseCoopers (PwC), about any relationship they or their families have with Itera.

Might all this fit with the theory that Gazprom's bosses set up Itera to enrich themselves at their shareholders' expense? "Without answers to the questions, everyone will suspect the worst," says Jim Henderson of Renaissance Capital, a Moscow brokerage.

Other investigations into the link with Itera are continuing. They may be more vigorous than PwC's audits, which never unearthed anything amiss in previous years. What would really satisfy outside shareholders, though, would be a full independent inquiry, and perhaps some prosecutions and recovery of the missing money. But there is no sign of that yet.

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Europe's fearless diplomat

Jul 5th 2001
From The Economist print edition

Mario Monti has blocked the biggest-ever industrial merger. Now he needs to put his own house in order

EPA

WHEN Mario Monti became the European Union's competition commissioner in 1999, Karel Van Miert, his distinguished predecessor, telephoned to congratulate him: "Now you will have to get used to being thought of as the most powerful man in Europe," quipped Mr Van Miert. On July 3rd the European Commission blocked the $42 billion proposed merger between General Electric (GE) and Honeywell on Mr Monti's recommendation. He could be forgiven for wanting to call Mr Van Miert back to say he was bang on, except that these days his stage is no longer European but global.

A look at Mr Monti's output on July 3rd reveals just how global and powerful his position has become. In addition to the GE/Honeywell decision, he found time to open an investigation into a merger of Brazilian iron-ore groups; to impose tough measures on IMS Health, an American health-information firm that stands accused of abusing a dominant market position in Germany; and to allow one European acquisition and one German joint venture to proceed.

It is GE/Honeywell, however, that has made the soft-spoken Mr Monti's reputation as the world's toughest regulator. It took strong nerves to block the deal, for surely Mr Monti's stance betokens a worrying split between Europe and America. After all, in May the deal was waved through quickly by America's Department of Justice (DoJ). GE confidently expected the same result in Europe. But Mr Monti calmly resisted huge pressure, noting that the decision to block was a "rare case where the transatlantic competition authorities have disagreed". Instead of less co-operation between authorities, he wants more. In a speech on July 4th, he called for the creation of a global annual forum at which antitrust regulators can share experiences and forge policies.

The pressure on Mr Monti is unlikely to abate quickly. President George Bush and several senators have grumbled publicly at what they see as unwarranted interference in an all-American deal, and have hinted that Mr Monti's true aim was to protect European companies. That has politicised the whole question of antitrust policy and opened a new front for transatlantic tensions. Mr Monti was at pains to say that he hoped the history of close co-operation between his team and American officials would not be jeopardised by a genuine difference of opinion. It will not be easy, however, to contain the issue if politicians decide that they want to exploit it.

A measure of Mr Monti's sense of diplomacy is that he could, if he chooses, deflect criticism of himself and his officials by throwing it straight back at the Americans. So far he has been judiciously silent on the question of whether the DoJ bungled its investigation and thereby forced the European Union to play the tough cop. He has also resisted the temptation to point out in public that American companies such as Rockwell Collins and United Technologies, rather than European firms, provided him with the main ammunition used to shoot down the merger. In at least one case, the same information was offered to the DoJ, which chose not to listen.

Plenty of observers, including Jack Welch, GE's departing chairman, have acknowledged that Mr Monti possesses a formidable combination of charm, intelligence and an ability to be polite even when he is being stubborn. A sign of his growing reputation is that he was offered the job of foreign minister in Silvio Berlusconi's new Italian government. Perhaps wisely, he preferred to stay in Brussels—although the offer points to a possible future career.

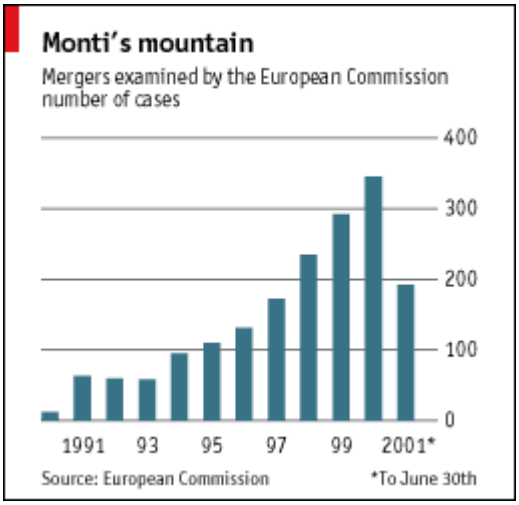
Mr Monti began his career as an economics professor and, despite what some critics say, a sound grasp of theory underpins his competition role. However, he is perhaps too relaxed when his team breaks new antitrust ground, as it did several times during the GE negotiations and in the case relating to IMS

Health. In essence, the Monti approach involves teasing out the commercial realities of complex, sometimes overlapping, industries and markets. That is fine, but it relies heavily on sounding out competitors, and rather less on asking customers for their views. Mr Monti needs to insist on a greater balance. He should also heed suggestions that his officials sometimes let their power go to their heads.

Heal thyself

Indeed, as the range of his activities expands, Mr Monti is coming under increasing pressure to change Europe's competition procedures and to make sure that his officials stick to agreed rules and precedents. His department has to scrutinise more and more deals. Although it has expanded in recent years, it remains under-resourced. When the EU's Merger Task Force (MTF) was set up in September 1990, its 47 staff had to decide on 60 cases annually. Now it has about twice as many staff, but last year looked at 345 transactions (see chart). Mr Monti has introduced a fast-track system for uncontroversial deals to ease the load, but almost two-thirds of all cases still need detailed work.

The lack of independent assessment within the MTF is also controversial. The same officials handle a case from start to finish, often forming strong opinions during the investigative phase. That can make it impossible for them to be objective when they have to adjudicate. Mr Monti has previously acknowledged that it might be better to have officials make their case to an internal judge who has no axe to grind. But he has yet to do anything to change the current arrangements. The challenge of managing and adapting the MTF as big companies grow increasingly global is arguably a greater one than making any particular ruling, however tricky. Mr Monti will be remembered for blocking GE/Honeywell. If he listens to his critics and truly reforms Europe's competition regime, he might just win a more impressive place in history.



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Spoilt for choice

Jul 5th 2001
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Professional-service firms are becoming vast diversified conglomerates, a strategy long since discredited elsewhere. Why should it work for them?

IN A recent cartoon, an insomniac wife lies on a tousled bed beyond the help of sleeping pills. In despair, she has woken her accountant husband: “Tell me again dear,” she is saying hopefully, “what it is that you do.” Accounting used to be that exciting.

The image, though, is out of date. Today’s accountants are no longer soporific. They work for firms that do an increasingly wide variety of things, and they want to do even more. In particular, they want to team up with lawyers in America and Britain so that they can, in the words of Nick Land, the chairman of the British arm of Ernst & Young, one of the biggest, “provide a more complete solution” for their corporate clients.

“Complete solutions” are all the rage among professional-service firms. Advertising-oriented groups such as Britain’s WPP are continually extending the menu of services that they offer to their clients, and information-technology service providers know equally few bounds. The strategy of Accenture, the largest firm of IT consultants, is to build “a network of businesses to meet the full range of client needs—consulting, technology, outsourcing, alliances and venture capital.” EDS, an outsourcing business that describes itself as “the leading global services company”, also owns A.T. Kearney, an old-established consulting firm that happens to be America’s sixth-biggest headhunter.

The auditing of big multinationals is now almost exclusively in the hands of five big firms (see chart 1). But the firms are not just auditors any more. The biggest of them all, PricewaterhouseCoopers, derived only about 40% of last year’s revenues of $19.6 billion from traditional accounting and auditing services.

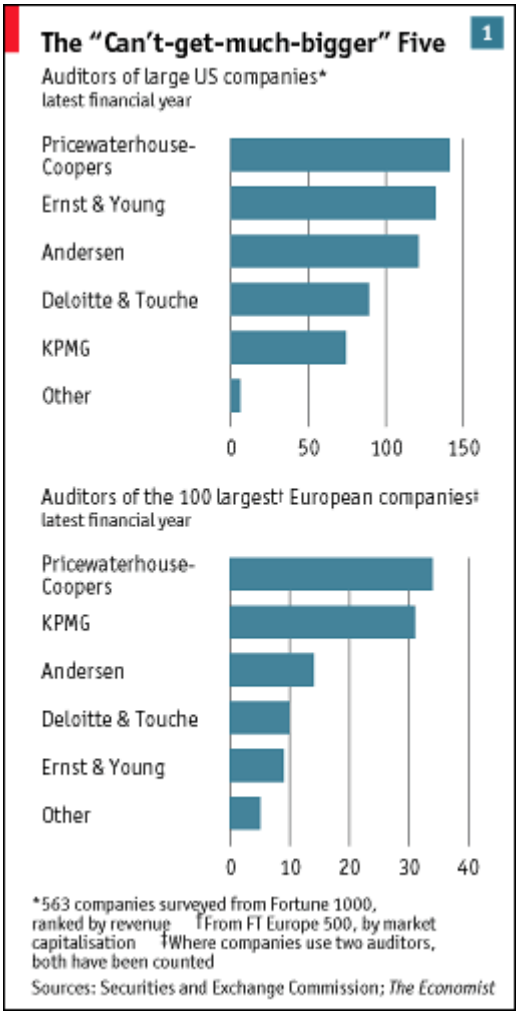
The firms are diversified conglomerates that span the globe hand-in-hand with their clients. Among the most conspicuous names on buildings in downtown Tashkent, for example, are those of Andersen and PricewaterhouseCoopers. Increasingly, the wives of the men who run these offices (and they are still mostly men) have to lull themselves to sleep alone.

But why are these firms so keen to become broadly diversified conglomerates when, as a strategy, diversification has such a poor track record? For years, stockmarkets have applied a “conglomerate discount”: they value diversified manufacturing conglomerates at some 20% less, on average, than the value of the sum of their parts. The discount still applies, in good times

and bad. Extraordinary manufacturers (like GE) can defy it for a while; more ordinary ones (like Philips and Siemens) cannot. The "synergy" that these groups invoked at their birth was supposed to make two plus two equal five; more often than not, it made them equal three.

Much of manufacturing industry came to regret its dabble with diversification. Michael Porter, a Harvard Business School professor, has calculated that three-quarters of the forays into unrelated industries undertaken by a sample of large American companies between 1950 and 1986 were subsequently sold off. A former executive of Blue Circle, a British cement maker, once said that his company diversified into lawn mowers in the 1980s (it bought the Qualcast brand) on no firmer grounds than "your garden is next to your house".

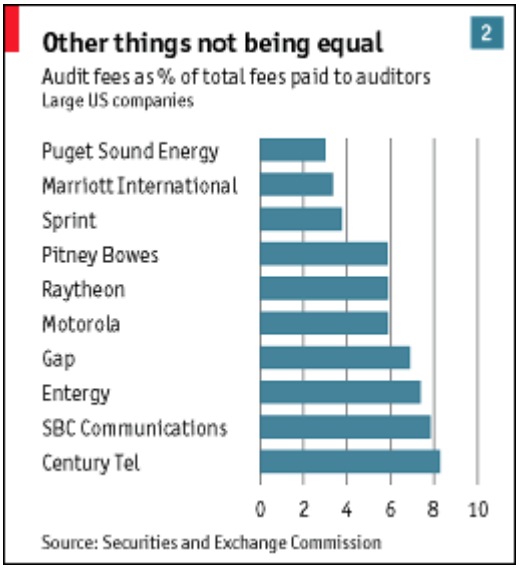
Today, the focus among manufacturing industries is on "core competencies". Blue Circle sold off its interests in trimming turf in the 1990s and is currently subject to an agreed bid from Lafarge, a large and focused French cement maker. "Stick to your knitting," the consultants are advising their clients, even as they are themselves energetically ignoring their own advice. Are they mad, blind or just different?



Two steps back

Last year, the accountants' desire to diversify suffered two big setbacks in America, the market that matters most. Both setbacks, however, look likely to be temporary. In the first, the Securities and Exchange Commission (SEC), under its then chairman Arthur Levitt, became concerned that the quality of information provided by publicly quoted companies might be compromised by the amount of (more lucrative) non-audit work that their auditors were performing for them. In 2000, for instance, the Marriott International hotel chain paid Andersen $1m for its audit and $30.3m for other services; Motorola paid KPMG $3.9m for its audit and $62.3m for other services (see chart 2). Could auditing be strictly independent, worried the SEC, when so much other business depended on it?

Confirming its worst fears was the case of Waste Management. The accounts of the garbage-collecting business have been audited by the Chicago office of Andersen (né Arthur Andersen) for more than 30 years, but the unqualified audited accounts for the years of 1992 to 1996 were subsequently found to have overstated Waste Management's pre-tax income by more than $1.4 billion. During that time, Waste Management paid Andersen $7.5m in audit fees and $11.8m for other services. In June this year, the SEC fined Andersen $7m for "improper professional conduct", its first such case for more than 20 years.



This was not mere aberrant behaviour by some far-flung outpost of the 85,000-strong Andersen empire. Chicago is the home of Andersen's worldwide headquarters, the gateway to its famous training centre at St Charles, Illinois—a gateway through which almost all Andersen partners pass several times a year.

The appointment of auditors is the responsibility of shareholders, but for the most part they take their responsibility too lightly. Waste Management's accounts are still audited by Andersen. Indeed, the company paid the highest audit fee in America last year ($48m), and Andersen picked up a further $31m from Waste Management that

year in consultancy fees.

About two-thirds of large quoted companies in America invite their shareholders to consider the appointment of their auditors each year. Proxy Monitor, an American adviser to institutional investors, is recommending that investors vote against the reappointment of their auditors in more than 10% of the cases where companies are giving them the option this year. Unfortunately, the number to take heed will be infinitesimal.

Most of the SEC's worries could be overcome if shareholders were more diligent. Its worries, however, may be overcome in another way. A new chairman, Harvey Pitt, has been nominated by the Bush administration and is now awaiting confirmation. Mr Pitt is a Washington securities lawyer whose views on auditing are in some respects diametrically opposed to those of his predecessor, Arthur Levitt. In 1998, for example, he wrote that the "performance of non-audit services can improve the audit function."

Most of the SEC's worries could be overcome if shareholders were more diligent

The SEC under Mr Levitt eventually backed away from its attempt to ban firms from (in particular) offering IT consulting services to their audit clients—but not before it appeared to have sent three big firms scurrying to divest their consulting businesses. Ernst & Young sold off its consulting arm to Cap Gemini, a quoted French company, for $12.4 billion in May 2000, while attempts by PricewaterhouseCoopers to sell its consulting business to Hewlett-Packard, and KPMG's proposed flotation of its American consulting arm, were foiled by the stockmarket's collapse later in the year.

These proposed divestments, however, had little to do with pressure from the SEC and more to do with a general realisation that non-strategic IT consulting (which is what all three firms were looking to divest) sits more comfortably in an IT-centric conglomerate than it does in an accounting-oriented one.

Legal attraction

The second setback to diversification last year came when the ABA, the American Bar Association, voted three-to-one against repealing its rule prohibiting lawyers from sharing fees with non-lawyers. In effect, that stopped in its tracks the desire of some American firms to become full multi-disciplinary practices (MDPs), offering the three hard-core business services—accounting, consulting and legal advice—under one corporate umbrella.

American lawyers plead that their work is special and their need for confidentiality and independence so great that the proximity of more commercially minded professionals might compromise it. But it doesn't take Adam Smith to smell a rat there. In May 1999, Robert Gordon, a professor of law at Yale, wrote to the ABA in his submission about MDPs: "Historically, the sad if hardly surprising fact has been that the organised Bar's resistance to new modes of practice has been to a considerable extent motivated by desires to protect the incomes of lawyers from economic competition or their status from erosion by groups perceived as interlopers."

For the most part, lawyers remain protectionist at heart. Understandably: the profits of blue-chip firms in places such as New York, London and Frankfurt hit a record high last year. Some of them are looking for cross-border links with other law firms, but it is the Big Five accountants that are pushing hardest for MDPs.

Not all accountants, though, are keen. BDO Stoy Hayward, part of BDO International, the world's sixth biggest firm (ie, the biggest outside the Big Five), is making a virtue of its decision to eschew legal services. "We believe it is important to be free to choose the best firm for the job when referring work on behalf of a client," says Chris Swinson, the firm's senior partner and a former president of the ICA, the British accountants' professional body.

The more diversified that firms become, the more they are exposed to potential conflicts of interest. This has been highlighted by the SEC's concern about auditors, but it applies in many areas, including, for example, forensic work where the interests of lawyers and accountants frequently conflict.

The more diversified that firms become, the more they are exposed to potential conflicts

Notwithstanding the American lawyers' resistance, MDPs are becoming a reality. Andersen alone employs 3,400 lawyers in 36 countries around the world, including some in New York who (for the moment) work only on legal

matters outside America. McKee Nelson, a firm of lawyers in Washington, DC, was set up in November 1999 with the explicit backing of Ernst & Young, to "use an alliance platform to leverage the knowledge, infrastructure and client base of a world-class professional-service firm"—in other words, to be an MDP whenever and wherever possible.

Britain is moving in much the same direction. In March, a report on competition and the professions by the Office of Fair Trading (OFT) came out in favour of MDPs, and the Law Society is now talking to the new government about what legislation is needed to make them happen. In France and Germany, lawyers are resisting the introduction of MDPs wherever possible, but the big accounting firms are setting up their own independent legal arms nonetheless. KPMG's law firm in France (called Fidal) employs 1,200 lawyers and is the biggest in the country.

The consensus of opinion is that MDPs will be commonplace in Britain within five years, and in America within ten. The OFT is in favour of MDPs because it believes they will provide "more open access to the professions"—particularly for smaller businesses—while Michael Napier, the president of the Law Society, says that they will provide more choice, which is what "clients want". Clients will not, of course, get much choice or open access if the market for corporate legal services comes to be dominated by the Big Five to the same extent as the market for auditing.

The value of old boys

From the service firms' perspective, there are two main arguments in favour of diversification: one is about reducing risk, and the other about pleasing clients. The risk that auditors worry about most today is that of being sued. Expensive settlements of shareholder lawsuits are on the increase—especially related to once high-flying IT businesses. In May this year, PricewaterhouseCoopers paid $55m to settle a suit alleging that it defrauded investors in MicroStrategy by approving accounts that inflated the earnings of the software firm. The way to reduce this sort of risk, however, is not to offer yet more services, but to seek incorporation or to set up as some sort of limited partnership.

Professional-service firms insist that they want to diversify because their corporate clients demand it. But the evidence for such a claim is hard to find. There are no corporate bodies noisily clamouring in favour of MDPs. A survey earlier this year found that, for strategy advice, more than three-quarters of a sample of large global businesses used different consulting firms from the ones that they used for advice on electronic business—services that they could easily, if they so wished, purchase from the same vendor.

Professional-service firms insist that they want to diversify because their corporate clients demand it. But the evidence for such a claim is hard to find

David Maister, a leading adviser to professional-service firms and a former academic at Harvard Business School, says that there is a yawning gap between what the big firms are offering and what their corporate clients want. He says they are offering a menu, a mere list, when what businesses really need is a "prime contractor"—someone who will integrate professional services in the way that a building contractor integrates electricians, plasterers, brickies, etc.

A few firms are providing this, he says, but they "can be counted on the fingers of a maimed hand". And most of them are young. Old firms find it hard to tack new services on to their existing structures. They all have cross-selling as their mantra, but the amount of it that actually takes place, says Mr Maister, "could be put on the back of a postage stamp".

Nevertheless, there is obviously a lot of business being done in one area by providers who do business in another. The figures that auditors are producing for the first time this year (at the SEC's behest) on the amount of non-audit business done for audit clients are surprising even the SEC. On average, for every dollar of audit fees, large publicly quoted companies in America pay their "independent" accountant $2.69 in fees for non-audit services. What these figures don't show, unfortunately, is the amount they pay other accounting firms for non-audit business. Without that, it is hard to gauge whether the amount of such business going to their auditors is exceptional.

The Andersen/Waste Management case may not be typical, but it is indicative of the way that things can work. Not only was Robert Allgyer, the Andersen partner in charge of Waste Management's audit, also the marketing director for the firm's Chicago office, but he worked for his audit client in another capacity as well. Andersen Consulting (now called Accenture), then a sister organisation of Arthur Andersen, charged Waste Management $6m for non-audit business on top of (and over the same period as)

Andersen's charges of $11.8m. Of that $6m, $3.7m related to a strategic review overseen by a committee of which Mr Allgyer was a member. Andersen Consulting billed Waste Management for Mr Allgyer's time while he was performing this service.

In professional-service conglomerates, old-fashioned networking is a powerful influence on business. The flow of individuals from firms to clients, and back again, is continuous and extensive. Until 1997, for example, every single chief financial officer in Waste Management's history as a public company had previously worked as an auditor for Andersen. In the case of HIH, a collapsed Australian insurer whose shareholders are threatening to sue its auditor, Andersen, three Andersen partners served at various times as HIH directors.

Accenture's "attrition rate" last year was more than 20%—ie, almost 15,000 people left the giant firm of consultants. Some were lured away to dotcoms, but many ended up in senior positions with actual and potential clients. McKinsey's old-boy network is the envy of all. Its roll call of chief executives includes Lou Gerstner, the boss of IBM; Harvey Golub of American Express; Lukas Mühlemann of Credit Suisse; Jeffrey Skilling of Enron; and Anton van Rossum of Fortis, to name but a few. It extends into other areas too: in Britain, for example, Howard Davies, the head of the FSA, the country's financial super-regulator, and Adair Turner, the former head of the Confederation of British Industry (CBI), both once worked for McKinsey. Is it surprising (or undesirable) that these people should call upon former colleagues to provide services for their new employers?

The power of the service firms' old-boy networks increases exponentially. Metcalfe's Law, named after Robert Metcalfe, a computer-networking pioneer, says that the value of a computer network grows roughly in line with the square of the number of users. A slight variation on this can be applied to old-boy networks: their value grows in relation to the square of the number of former employees working for clients, and their elevation in the corporate hierarchy.

The power of the service firms' old-boy networks increases exponentially

The addition of legal (and other) services to the big firms' menu of offerings will expand their networking potential considerably. At a time when there is downward pressure on fees for professional services of all kinds, that could help explain their enthusiasm for diversification. What their clients want, however, is the best service for the job in hand with the least amount of hassle. In the age of the Internet, asset-heavy conglomerates are even less well suited to meet customer demand than they were 20 years ago.

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Singapore banks

After the slumber

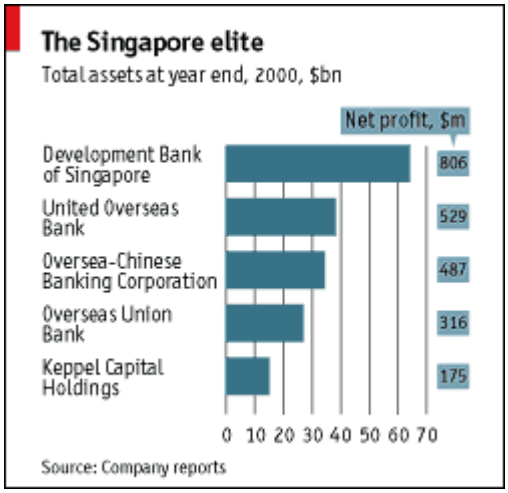
Jul 5th 2001 | BANGKOK
From The Economist print edition

Singapore's coddled banking sector gets a shake-up

WHERE did Singapore's bankers get all these strange ideas? For the past few weeks they have toyed with hostile takeovers and bidding wars, and they whisper impolite things about their rivals. On top of that, the government is pushing a radical notion of its own, by making it ever easier for foreign banks to compete with the locals. If this keeps up, Singapore's bankers may soon be introduced to two groups of distant strangers: customers and shareholders.

After a series of offers since June 12th, all five of Singapore's banks are now engaged in takeover bids, as buyers or targets. Oversea-Chinese Banking Corporation (OCBC) started the fun by launching a S$4.8 billion ($2.6 billion) hostile bid for the smallest of the five banks, Keppel Capital Holdings. The offer for Keppel promptly drew everyone's attention to Singapore's second-smallest bank—and thus the next logical takeover target—Overseas Union Bank (OUB). Soon enough, Development Bank of Singapore (DBS), which is the city-state's largest bank and has already done several foreign deals, launched a hostile bid for OUB.

The need for consolidation has been apparent for years, yet the whirl of activity is dizzying. United Overseas Bank (UOB), for instance, made its own offer for OUB, trumping DBS's S$9.4 billion bid by S$600m. To spare the sensitivities of OUB's 95-year-old founder, Lien Ying Chow, UOB invited all OUB's directors to join its board after the deal. To help this friendly offer succeed, Mr Lien responded by agreeing to sell his 15.7% stake to the new bidder. DBS, however, has yet to withdraw its offer, and some analysts now expect a fight for Keppel as well.



While Singapore's bankers stirred this alphabet soup, the government tossed in, from a great height, its own potato. On June 29th the Monetary Authority of Singapore (MAS) unveiled the second phase of a liberalisation plan that began two years ago. It will allow "qualifying full banks"—foreign banks with special licences—to expand their domestic services. The MAS will let each foreign bank double its branches, to ten. And, although the foreign banks' customers still may not use the locals' cash machines, they will soon gain access to better payment services, such as direct debiting.

In addition, the MAS will allow two new foreign banks to become qualifying full banks. At present, only four have been granted access: America's Citibank, Britain's Standard Chartered, France's BNP Paribas and ABN Amro from the Netherlands. As the wallflower at this dance, HSBC, a British-based bank with a huge pan-Asian business, is an obvious candidate for one of the slots.

All this activity is moving Singapore closer to the kind of banking system that the local regulators have in mind: two or three big local banks, competing with half a dozen, suitably hamstrung, foreign rivals. Time, perhaps, for a nap before plotting their next move.

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Takeovers in Europe

Pull up the drawbridge

Jul 5th 2001 | STRASBOURG
From The Economist print edition

Efforts to make it easier for companies to be taken over in Europe have fallen at the last minute

IT COULD not have been closer. On July 4th the European Parliament split 273-273 on plans to push through a new directive establishing a cross-border code for company takeovers in Europe. For a brief, confusing moment Nicole Fontaine, the parliament's president, declared that this meant the vote had been passed, but she had got her procedure muddled. Then, when the tally of votes was published, it seemed as if they might have been miscounted, and the directive passed after all. False alarms, false hopes. After 12 years of work, it looks as if it is back to the drawing board for the takeover directive.

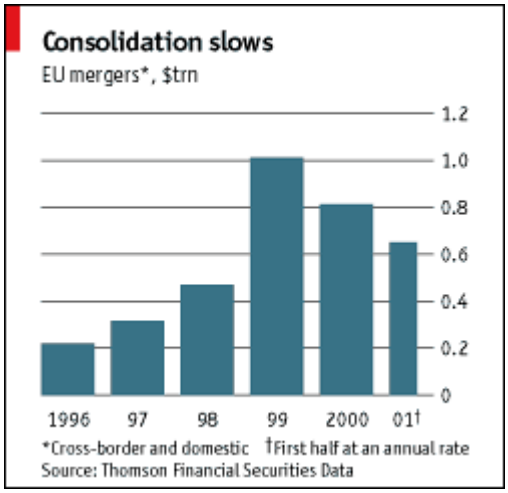
The failure is a blow for economic liberalisers, who saw it as a key part of their strategy for sharpening economic competition within the European Union. The thrust of the directive was to make it harder for European corporate bosses to ward off a hostile bid without first consulting shareholders. The idea was that shareholder rights would be strengthened, and managers forced to become more efficient.

A mere 2% of takeovers in Europe are hostile. Such bids are not by nature good in themselves, but as Chris Huhne, a British Euro-MP, says, the possibility of them exerts a welcome pressure on managers. Frits Bolkestein, the commissioner in charge of the internal market, called the rejection of the code a setback to having an integrated capital market in Europe by 2005 and to "making Europe the most competitive economy in the world by 2010." Both these goals were endorsed by the leaders of the 15 members of the European Union at a summit in Lisbon over a year ago.

Mr Bolkestein clearly blames pressure from corporate Germany, transmitted through its government, for the takeover code's rejection. For most of the past 12 years the German government was in favour of a directive. It recently changed its mind—becoming the only state to oppose the directive. That did not bind German Euro-MPs, who have led the opposition in the European Parliament.

Mr Bolkestein spoke of German companies falling back on Europe's old "corporatist reflex". People close to the commission point to the fact that Gerhard Schröder, Germany's chancellor, hails from lower Saxony, the home of Volkswagen, which fears it may become a takeover target as the car industry consolidates. Klaus Lehne, the German Euro-MP who led the opposition to the directive, is from the constituency that is home to Mannesmann, a

German telecoms company taken over after a bitter fight by Vodafone of Britain.



Still, it would be misleading to portray the directive's failure as entirely a "German plot". The parliamentary opposition also took in Christian Democrats and Socialists from various other European countries. Some of the former were sympathetic to pleas from home-country companies, fearful of takeover; the Socialists, meanwhile, were motivated by their usual hostility to acquisitive capitalism.

The European Commission talks of trying to come up with a new code that might pass muster with the parliament. This could take up to three years. The directive's defeat will not prevent hostile takeovers across European frontiers. After all, Vodafone managed to acquire Mannesmann under the old rules. But it will certainly slow corporate restructuring across Europe, particularly in Germany. It will also make it harder to establish a genuine European single market. The free flow of goods and a common currency are one thing, but if companies have to deal with 15 different takeover codes when making cross-border acquisitions, a true single market is still an illusion.

This setback for economic liberalisation comes at a bad time. European economies are slowing. Other liberalising measures proclaimed at Lisbon—for instance, the liberalisation of energy markets, postal services and the completion of a single financial market—have got nowhere.

Meanwhile, the euro still struggles against the dollar. One of the aspects of this is that capital flows to the United States have been much stronger than flows to the EU. Encouraging shareholder capitalism in Europe, and making takeovers easier, might have persuaded global investors to put more of their money into the EU. With the failure of the takeover code, it is easier for the EU's critics to paint it as a bastion of unreformed corporatism.

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Labour markets

Pro-active

Jul 5th 2001
From The Economist print edition

The OECD recommends an activist policy for labour markets

THIS week, the OECD released its annual *Employment Outlook*, an assessment of labour-market developments and prospects in member countries. A theme of this year's report is that governments should target policy towards more "active" programmes that focus on getting people into jobs (such as job-search assistance and training) and away from "passive" programmes that take care of them and give them income while they are out of work (unemployment insurance, for instance).

The call to action is not new, but it has been only modestly heeded. Between 1986 and 1998, two years with similar unemployment rates, average OECD spending on active labour-market policies rose only slightly, from 35% to 37% of total spending. In America, the trend has been toward less spending on passive programmes at a given unemployment rate, without much change in active programme spending. Meanwhile, much of Europe has raised its active spending a little. Spending on active policies varies widely by country. In 1998 such spending accounted for 0.2% of GDP in the United States, 1.3% in Germany, and 2% in Sweden.

Do active labour-market programmes actually reduce unemployment? Here, the evidence is still thin. What is clear is that broadly targeted programmes, such as general employment subsidies and training, tend to be ineffective. On the other hand, simple programmes, such as intensive help with searching for jobs, are very successful—and also cheap.

Programmes need to keep their target population firmly in mind. One reason for this is that the poor, whose labour-market prospects are most precarious, are a diverse group. Most poor people tend to move in and out of poverty, yet most of the time spent in poverty is accounted for by a small group of "hard-core" poor.

Thus policies aimed at helping the labour-market prospects of the poor must take into account which poor they are dealing with. "In-and-out" poor will benefit from programmes to help them stay in jobs and move up the job ladder. The hard-core poor are a more difficult bunch, but probably need training programmes to help them improve their employability.

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Wall Street research

Neither buyer nor seller be

Jul 5th 2001 | NEW YORK
From The Economist print edition

The wonderful new world of investment research

EVERYONE these days, Congress included, likes to bash the share analysts at Wall Street's big investment banks for their shoddy or conflicted investment research. In midtown Manhattan, a business founded three years ago by men barely out of university is moving into larger quarters for the fourth time. Gerson Lehrman is making money, in an intriguing way, from the distrust.

As important as what the group provides—investment research—is what it doesn't provide, namely, banking, stockbroking and money management. Indeed, it does not even provide the most visible element of traditional investment research: "buy" and "sell" recommendations. Still, it has as customers plenty of hedge funds, many of America's big asset-management companies, including Fidelity and Putnam, and even some asset-management arms of big investment banks.

Gerson Lehrman's initial idea was to publish books about how dynamic industries, such as telecoms or pharmaceuticals, function. As it happened, nobody wanted to read the books. But they did want to speak to the authors, particularly about areas subject to complex regulation or rapid change. Getting the hint, and having little to lose, Messrs Gerson and Lehrman transformed their company into an information exchange.

Experts in health care, energy and technology were recruited to be available at hourly rates, set by the experts themselves, ranging from $100 to $2,000. Clients pay $6,500 a month for each area to which they want access, and that gives them the right to consultations by telephone with experts, usually for 45 minutes. Gerson Lehrman now has 8,500 of these associates, and annual revenues of $12m.

The issues can be fairly broad (a tutorial on heart disease, for instance) or narrow (eg, on specific side-effects of rare-cancer treatments). Some may require merely a junior faculty member at a decent medical school; others, the head of oncology at a major hospital. In each case, an investment manager calls Gerson Lehrman and is passed on to an expert, whose help is then evaluated. Those who provide consistently valuable advice, and who price their services appropriately, get more business.

One disappointment about what Gerson Lehrman offers might be over how much work clients still have to do for themselves. Investment research, it turns out, is actually quite hard. First, you must know what are the crucial questions to ask. Then, just as harrowing, you must know what to do with the answers. Consider, for example, the case of JDS Uniphase and Cisco, two companies whose shares climbed and then crashed. Gerson Lehrman put out two brief reports, one covering a laser pump produced by Uniphase and another on a router produced by Juniper Networks, a product that competes directly with Cisco.

For the right kind of investor, this information is a crucial part of a larger puzzle about these companies' viability. For many others, it is so much techno-babble. No doubt some wish Gerson Lehrman would distil things down to a simple share recommendation. But then the root of the malaise about investment research on Wall Street may not be the rotten advice on what stocks to buy, but the rotten advice that very difficult decisions about investments could ever be easy.

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Share-trading in America

The trouble starts at home

Jul 5th 2001 | NEW YORK
From The Economist print edition

Are fund managers to blame for higher trading costs?

DESPITE the growing popularity of automated electronic share-trading systems (ECNs), the costs of trading shares remain relatively high for many American investors, and especially for fund-management firms. The average institutional trade executed through a broker costs around 5.5 cents per share, compared with 0.25-2 cents a share available over ECNs. Still, fund managers have not switched en masse to ECNs.

To explain this, it is tempting to blame inefficient regulation, technical glitches that have beset both Nasdaq and the New York Stock Exchange (NYSE), or even the NYSE's dogged refusal to scrap its crowded trading floor. Still, the biggest reason may be the fund managers themselves, according to a new study by Robert Schwartz of Baruch College and Benn Steil of the Council on Foreign Relations*.

In order to find out how fund managers choose where to execute their trades, the economists surveyed chief investment officers and head equity traders at 72 large fund-management firms worldwide. They found that fewer than half of institutional commissions were allocated by those who actually do the trading—and it is these who probably have the best idea where to execute a trade most effectively. In fact, 40% of commissions were allocated by the institution's portfolio managers, 12% by its analysts and 10% by its clients. Some 14% of managers went so far as to tell their trader which brokerage to use. Crucially, 64% instructed their trading desk, for most transactions, to base their choice of broker on "rewarding good research".

Payments to brokers in exchange for research and other services besides trade execution, including trading or information systems and access to initial public offerings of shares, are known as "soft commissions". They are far more common in America, where they accompanied 32% of trade orders by managers surveyed, than in Europe (18%). Over half of all the commissions paid by American institutions are "soft", ie, pre-allocated to particular brokers as part of an explicit agreement.

The effect of soft commissions is to pass the cost of research and other services on to the fund manager's clients—hidden in the form of poorer performance, rather than being more visible as higher management fees. Managers perhaps believe that clients will rarely fire them for below-average performance, though they might do for above-average fees.

As well as concealing true costs from clients, the result is that trading costs, even after stripping out the cost of "soft" services, are higher than they need to be. Once somebody has decided to pay a soft commission, it seems, he does not bother to scrutinise too closely what sort of trade he gets for it. And, say Messrs Schwartz and Steil, even when trading costs are measured, the widely used "volume weighted average pricing" method misses the damage done by soft commissions.

Ideally, fund managers should be forced to bear the costs of research and other services themselves, and it should be reflected in their fees. Trading should be done in ways that get clients the best execution, and maximise performance. Why don't clients see this for themselves? Perhaps they don't realise how much they are losing. Regulators could help. Earlier this year in Britain, a commission chaired by Paul Myners proposed the scrapping of soft commissions. This has met resistance in the City of London. It would meet even more in the United States.

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* "Controlling Institutional Trading Costs: We Have Met the Enemy, and They are Us". Journal of Portfolio Management, forthcoming.

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About sponsorship

Turkey

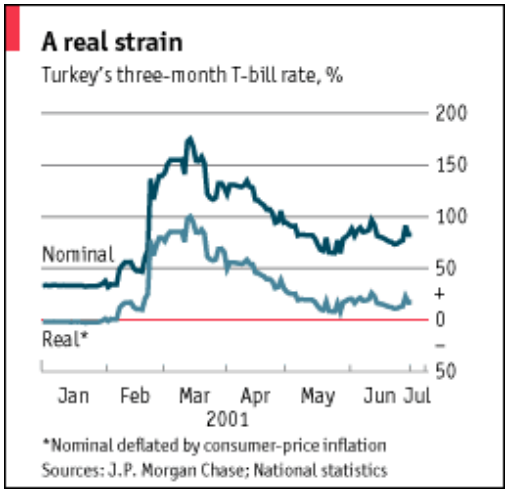
Hardball from the Fund

Jul 5th 2001 | ANKARA
From The Economist print edition

Turkey is playing politics with its recovery programme, says the IMF

ON JULY 2nd the International Monetary Fund said that it was delaying Turkey's next $1.6 billion instalment of emergency funds until it was satisfied that the three-party coalition government had shown its commitment to a $15.7 billion economic programme signed in May. The Fund's chief objection is the brazenly political colour of appointments to the board of Turk Telekom, slated for privatisation. The programme needs to get back on track, if Turkey is to avoid another bout of financial jitters.

The IMF programme had many conditions, and one was that a new board for the telecom monopoly should have professional, non-political appointees. The IMF saw the appointments—which keep the same chairman and include four Nationalist Action Party stooges—as the last straw. The World Bank followed the IMF by delaying $1.7 billion of public-sector and agricultural loans.



Kemal Dervis, Turkey's economy minister, was in Washington, DC, this week trying to put the programme back on the rails. That seemed likely to need more changes to the Telekom board. (Mr Dervis had a fierce battle just to get two professionals, and retired military ones at that, on to the new board.) Or it would need some smart talking with the IMF's managing director, Horst Köhler. Mr Dervis, a former World Banker, is good at Washington-speak. In Ankara, though, the knives are out. His support in the cabinet is falling.

Turkey's financial markets remained fairly calm, in the belief that a compromise could be found in Washington. IMF insiders acknowledge that Turkey has made progress on other parts of the programme. At the heart of reforms is a restructuring of the banking system, which nearly collapsed during Turkey's crisis last February. State banks have since been recapitalised or merged. A first step was taken this week to close Emlak Bank, a redundant state mortgage bank. Under-capitalised private banks, under a deposit-insurance umbrella, are being sold or closed.

The finance ministry's chief challenge is to get to grips with the burden of domestic debt, now equivalent to 79% of GDP, while capping inflation and stabilising the exchange rate. In June, the government swapped $7.4 billion-worth of short-term domestic bonds for paper with a longer maturity, some of it indexed to the dollar exchange rate. That encouraged Turkey's big banks—which were nearly killed by short currency positions in February—to hedge their dollar liabilities with these dollar-indexed bonds.

In return, the finance ministry expected them to show more appetite for bidding in subsequent bond auctions. Yet the banks have been reluctant—suspicious, like the IMF, that politics will stymie reform, drive up inflation and sink their newly bought bonds. Last week, the ministry had to offer bonds yielding 92% before the banks would buy them. That was seven percentage points higher than its target, which implied a real interest rate of around 18%.

Unless this programme bites, and inflation comes down, things will remain hard for Turks. "The taste has gone out of our bridge game in the local café," says a retired headmaster. Nobody takes risks in the bidding any more. The losers have to buy a round of tea at 150,000 liras (12 cents) a glass.

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Cricket

'Owzat?

Jul 5th 2001
From The Economist print edition

Economics as well as corruption accounts for scandals

THE latest battle for the Ashes—as the series of five-day cricket matches between England and Australia is called—began on July 5th under something of a cloud. The trouble was not the weather at the ground, nor the chasm in class between Australia and all others, but the match-fixing scandal that has sullied the sport's image. Five senior players have been banned for life; suspicion still surrounds others.

Cricket's economics are partly to blame, say two British economists, Ian Preston and Stefan Szymanski, and a law professor from America (yes, really), Stephen Ross*. Although virtually all the money generated in cricket comes from international matches, much of it is used to prop up domestic competitions, such as the English county championship, where a man and a dog count as a crowd. Top cricketers receive a much smaller share of the pot than do the stars of other sports: maybe 10%, against 50% elsewhere. The gap between their earnings and those of mere journeymen is relatively narrow.

This has made the corruption of leading cricketers remarkably cheap, costing bookmakers just a few thousand dollars. The economists' answer is to find a new source of money with which to pay the best players and cut out temptation. They suggest an international tournament between eight or so clubs, specially created for the purpose, based in big cities in cricketing countries. Because top cricketers would play in every match, the television rights would surely fetch a pretty sum. Unlike national teams, clubs would be free to compete for players, and so would bid up their salaries.

Might it happen? The economics looks right, and cricket authorities are no longer traditionalists, at least when money is at stake. In one-day matches, coloured clothing and night-time play are now common. In 1999, Australia's venerable interstate trophy, the Sheffield Shield, was replaced by something called the Pura Cup, after a brand of milk.

Even so, the idea faces obstacles. The fixture list is already crammed, and the scheme could upset existing, influential "first-class" clubs, such as English counties, which would surely lose importance—and might fear losing money too.

* "Seizing the Moment: A Blueprint for Reform of World Cricket". University College London Discussion Paper in Economics. www.ucl.ac.uk/~uctp100/bluprint.pdf

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About sponsorship

Economics focus

A bundle of trouble

Jul 5th 2001
From The Economist print edition

Behind antitrust actions against Microsoft and General Electric lie concerns about "bundling" different products together. Is bundling really so bad?

IN ENGLISH schools, "bundling" is what happens when boys knock a fellow pupil to the ground and then pile on top of him. Economists use the term to describe something less rough-and-tumble, yet, some fear, equally suffocating to the victim: bundling two or more products together as a package, and selling it for a single price.

The world's two biggest companies, by market capitalisation, are under fire from antitrust authorities, in part because of concerns about bundling. On June 28th, an American appeals court upheld parts of an earlier judgment that, by bundling its Internet Explorer browser with its Windows operating system, Microsoft was seeking to preserve, or even extend, a monopoly position in operating systems. On July 3rd, the European Commission blocked General Electric (GE) from acquiring Honeywell, because it feared that the combined firm, by bundling together engines, electrical components and trade financing, would increasingly dominate the aircraft-manufacturing business.

In the 1940s, America's Supreme Court concluded that "tying agreements serve hardly any purpose beyond the suppression of competition." Economists have long challenged that absolutism. Many now think that, though there are exceptions, selling bundles of goods together as a package can be a source of economic efficiency.

Bundling covers many things. Two or more of the same product might be sold as a package—a "buy one, get the second at half-price" deal, say, or a railway season ticket. A camera might be sold in a box with a free film; a hotel room might come with accompanying breakfast.

A product can also be bundled together with a loan. Financial bundling has become so widespread that three economists at Morgan Stanley—Steven Galbraith, Mary Viviano and Elmer Huh—suggest in a recent report that, as manufacturers such as GE, General Motors and Lucent grow ever more involved in providing finance, so "manufacturing is becoming the loss-leader of the profit chain for many companies." In other words, give away the product; make money on the lending that is bundled with it.

Bundling can be good for consumers. It can reduce "search costs" (the bundled goods are in the same place), as well as the producer's distribution costs. There are lower "transaction costs" (because a single purchase is cheaper to carry out than multiple ones). And the producer may be a more efficient bundler than the customer: few of us choose, after all, to buy the individual parts of a car to assemble them ourselves.

Win some, lose some

In perfectly competitive markets, bundling should happen only if it is more efficient than selling the products separately. Where there is less than perfect competition—that is, most markets—economic models suggest that bundling sometimes benefits consumers and sometimes producers. Nicholas Economides, of New York University, says that when firms have a measure of market power, they can engage in price discrimination, charging different prices to different customers. Bundling can play a part in price discrimination, as different bundles of goods and prices may appeal to different customers.

Price discrimination in general, and bundling in particular, is usually a profit-maximising strategy for a producer that enjoys substantial market power, says Mr Economides. But if there is a deal of competition,

two rivals selling bundled goods may see their margins fall even more readily than if they were not bundling.

Wherever there is market power, the antitrust authorities have reason to be watchful. Bundling a monopoly product with one that is competitively provided may result in the competitive market being distorted. But it would be wrong to assume that bundling is inevitably bad in those circumstances. If there is some loss of consumer choice, the cost may be outweighed by efficiencies from bundling. Each case must be judged on its merits.

The merits are harder to assess where there is “pure bundling”, involving products available only as a package, than where there is “mixed bundling”, with products available both as a package and individually.

Microsoft’s package of Explorer and Windows is a pure bundle. On the face of it, requiring Microsoft to sell Windows and Explorer as separate products as well as bundled ones would end the arguments—except that Microsoft claims they are not a bundle at all, rather a single product incapable of being broken into parts. In the past, such claims have been resolved by assessing whether a viable market exists for each product on its own: if it does, the product is a bundle.

Yet, as the appeals court noted, this does not work well in Microsoft’s case, because any innovation that improves an integrated product might be stifled. Again, the costs and benefits of any such innovation, and whether it constitutes a genuinely new, integrated product, not a bundle, should be judged case by case.

Product definition was also an issue in the proposed merger of GE and Honeywell. The European Commission concluded that GE’s aircraft-leasing arm would favour GE/Honeywell’s competitively priced bundles of engines and components for aircraft it financed, over (perhaps unbundled) alternatives sold by competitors. Maybe. But aircraft financed by GE could equally be regarded as a bundled product in competition with other, bundled aircraft. As long as a merger of GE and Honeywell did not reduce competition in this end market, and it appears it would not have done, should the antitrust authorities have a say in who makes the components that GE chooses to include in its bundle?

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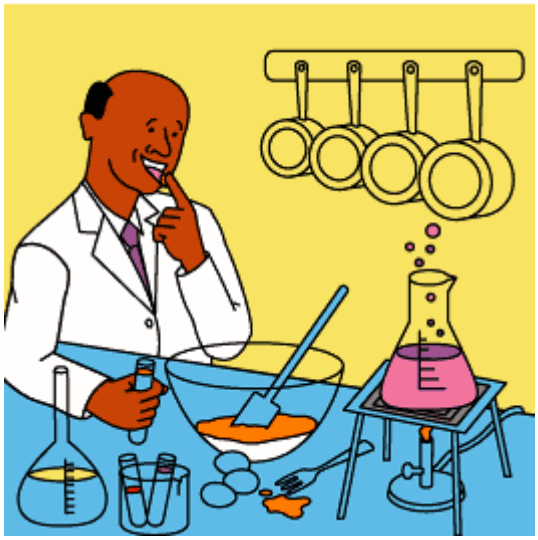
About sponsorship

The technology of taste

Food for thought

Jul 5th 2001 | NEW YORK
From The Economist print edition

Nowadays, you not only are what you eat; you R&D what you eat. Food makers have been meeting to discuss the latest in flavours, ingredients and processes



TO CAJOLE nervous students into the chemistry laboratory, teachers used to say that the subject was like cooking. These days, it is truer to say that cooking is like chemistry. In a cut-throat market, food companies are unwilling to leave anything to chance. They must constantly formulate new flavours, ingredients and processing methods if they are to keep abreast of their competitors.

As a result, their research laboratories have never been busier. A study published in November by *Prepared Foods*, a trade magazine, showed that 42% of the 331 food manufacturers surveyed had plans to increase their R&D budgets by at least 15% in 2001; only 3% said that their R&D budgets would drop.

This money has spurred the development of new ideas in food technology. (These innovations can be thought of as falling into two broad categories: they are either the kind that customers would like to know about, or the kind that they would probably rather not hear of.) Last week, at the Institute of Food Technologists' annual meeting in New Orleans, the industry's representatives convened to compare notes on how to capture their customers by the tongue and hold on fast.

Inside the sausage-factory

To lower cost or improve texture, food manufacturers often have to replace one substance by another that tastes nothing like it. One popular substitution is soya protein for meat. In addition to being cheaper than meat, soya has (at least in America) the added advantage of being marketable. The country's Food and Drug Administration, which regulates such matters, has recently decided that if a foodstuff contains more than 6.25g of soya per serving, manufacturers can state on its label that eating soya may reduce the risk of heart disease.

That is a nice bonus. Unclogged arteries are not, however, the main point of eating hamburgers. Flavour is. So, to find out how far hamburgers can be "extended" with soya, Keith Cadwallader of the University of Illinois at Urbana-Champaign analysed differences between the aromas of pure beef hamburgers and those containing 25% soya protein.

Dr Cadwallader and his team used a gas chromatograph. This works by blowing a mixture of volatile chemicals (which flavour-creating compounds necessarily are) through a column of powder that absorbs and releases those chemicals at different rates. What emerges from the column is a series of "peaks", each of which corresponds to a particular compound.

The researchers were thus able to determine the precise chemical profiles of the smells of soya-based and beef-based hamburgers. Surprisingly (and gratifyingly), adding a bit of soya to a hamburger may actually improve its flavour. The mixed burgers had higher levels of certain sulphur-containing compounds that are believed to augment the meaty "notes" in a burger's aroma.

On the other hand, the research of Margaret Hinds at Oklahoma State University shows what a fine line there is between temptation and disdain. Using a group of 81 untrained testers, she conducted a comparison of five commercially available burgers made from soya (and one made from beef, as a control).

The hue, the firmness and the chewiness of the burgers correlated with how acceptable they were to consumers. (Colour was determined precisely using a colourimeter; a texture analyser bent and compressed each burger to work out how much it yielded.) Not surprisingly, consumers preferred burgers that had characteristics close to those of beef. Only one soya-based burger was close enough to pass muster.

Other researchers offered results on useful new ingredients for meat processing. Lynn McMullen, of the University of Alberta, and her team claimed that a gum made from barley could be used to replace the “mouthfeel” of fat in low-fat sausages. Tony Payne, from Ajinomoto USA, an American subsidiary of a Japanese ingredients firm, described how the firm’s enzymes bind bits of processed meat together to give the feel of a piece of whole muscle (definitely in the “you didn’t want to know that” category). Ingolf Gruen’s group, from the University of Missouri, in Columbia, showed that adding antioxidants to convenience foods that contain cooked beef may reduce their “warmed-over” flavour, a funny taste that seems to come from the build-up during storage of substances that react with a meaty chemical called thiobarbituric acid.

Currying flavour

Food, and its consumers, are notoriously faddy. This year, flavour makers are insisting that bolder tastes are in fashion. Frito-Lay, a snack-food maker, has recently launched a line of “gourmet” crisps designed to appeal to the more discerning consumer. The company’s laboratory started by generating 300 flavours, including Thai curry, blue cheese, lemongrass and tandoori chicken. Eight of these flavours made it to the final round and, after getting 400 consumers to sample them, Frito-Lay decided to mass-produce only four: cheddar and jalapeño; garlic and herb; barbecue; and something referred to as “classic”. This quartet seemed to please the American palate most.

That sort of market research, though, is both time-consuming and expensive. It would speed things up, and probably cut costs, if it could be mechanised.

To a certain extent, it can be. Cheddar cheese, coffee and tea researchers are all exploring the use of electronic noses to rate their foodstuffs. Simple versions of such devices employ a set of sensors made of special polymers linked to electrodes. The volatile compounds that make up an aroma cause these polymers to change shape, which alters the resistance to the current passing through the electrodes. The result is an electrical “fingerprint” of an aroma.

So far, the electronic noses developed by firms such as Alpha MOS, of Toulouse, France, have worked best for quality-control purposes. These machines compare products’ aroma-fingerprints with pre-programmed standards that are known to correspond with what people have said that they like. And the range of senses that can be substituted electronically has now been extended to include taste as well as smell. Recently, Alpha MOS has launched a second analyser—an electronic “tongue” that can fingerprint the compounds dissolved in a sample of liquid. The machine is accurate enough to work out, for example, whether the vanilla extract in a sample originated in India or in Malaysia.

Even in matters culinary, however, the proof of the pudding is not always in the eating. The success of a food product also depends on the cleverness of its marketing. To this end McCormick, a flavouring company based in Maryland, has commissioned a “craveability” study from Moskowitz and Jacobs, a market-research firm in White Plains, New York. The intention is to discover which descriptions of particular foods most induce craving in consumers.

The preliminary results show that for fast-food hamburgers, the descriptions rated as most enticing were “a grilled aroma that surrounds a thick burger on a toasted bun” and “lots of grilled bacon and cheese covering the grilled juicy hamburger on a lightly toasted bun”. Other blurbs, such as “with horseradish sauce” and “when it’s cold outside and the burger is warm and inviting”, actually put people off hamburgers. And that was before they knew what was in them.

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Feeding tomorrow's troops

Food fight

Jul 5th 2001
From The Economist print edition

A new report speculates on army rations of the future

LIKE Popeye eating cans of spinach, soldiers of the near future will dine on special food that makes them fighting fit—at least according to a report by America's National Research Council. The report, entitled "Opportunities in Biotechnology for Future Army Applications", is short on detail. But its 16 authors, led by Michael Ladisch, a biological engineer at Purdue University, reckon that high-tech chow will, within the next 25 years, protect troops from attack by biological weapons, insulate them against cold weather and even make them visible to their commanders by satellite.

People are already experimenting with food plants that have immunity-inducing genes from viruses in them, so the first of these ideas is not that incredible. It would be useful, though. Vaccinating soldiers the traditional way is slow, costly and (for the troops concerned) unpleasant.

The idea that special enzymes could be engineered into plants, to make food derived from them easier to digest, is more speculative. But the authors are not shy about such speculation. Such enzymes would, they reckon, make a meal's calories available to the soldier more quickly, heating him up in arctic conditions. (Manufacturers of certain breakfast cereals would, no doubt, be interested in this idea.)

An even wackier proposal is that, along with their rations, soldiers of the future will ingest "biomarkers". These are chemical tags that would allow troops equipped with the right sensors to detect their fellow fighters (the chemicals would probably work by absorbing light in particular, recognisable ways). That might help to reduce "friendly fire" incidents, in which soldiers accidentally kill their comrades. Indeed, such tags might even be visible from suitably equipped satellites, according to the report. That would allow officers to "see" their men all over a battlefield, even when the enemy cannot.

One of the report's less appetising speculations is that biotechnology might allow soldiers to create "edible, digestible, nourishing food from raw materials that might be foraged on the battlefield." Dr Ladisch and his colleagues do not, however, detail what those raw materials might be, nor how they might be turned into something scrumptious. Perhaps that is just as well. If an army marches on its stomach, the stomach needs to be a strong one.

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Nanotechnology

The next small thing

Jul 5th 2001
From The Economist print edition

Researchers have designed a bone substitute from the molecules up

THE way that atoms are arranged matters. Diamonds, charcoal and graphite are all made of the same substance—carbon. Yet only one atomic arrangement is suitable for an engagement ring.

The same is true of hydroxyapatite, the material that bones are made of. Although chemists can whip up a bucket of the stuff in no time (it is a form of hydrated calcium phosphate), the result is rarely suitable for patching up broken bones because its structure is too weak. As a consequence, those bones that do need to be screwed together in order to heal are usually mended with implants made of titanium.

Edward Ahn and his colleagues at Angstrom Medica, of Cambridge, Massachusetts, hope to change that by using a process that controls the formation of crystals of hydroxyapatite at an atomic scale. The result is a version of the substance that has the strength of steel.

This material, dubbed NanOss by the company, is composed of “nanocrystals”. These crystals are a mere 100 nanometres (billionths of a metre) across, and are all more or less the same size. That gives the material strength, as there are fewer places for stress to build up and fractures to form than in hydroxyapatite made haphazardly of larger, more heterogeneous grains.

The details of the process used to create NanOss are currently a commercial secret (they involve dissolving together the right proportions of calcium, phosphate and hydroxide ions, while precisely controlling the acidity, temperature and timing of the process). The result, however, is a precipitate of nanocrystals of a predetermined size, shape and purity. These are retrieved from the solvent and consolidated into their final shape, such as a screw.

An additional advantage of nanocrystals is that they are small enough for the cells that live inside bones to latch on to. These cells are also able to engulf the crystals, break them down, and remodel them into real bone. Over time, therefore, implants made of NanOss should be incorporated seamlessly into the once-damaged tissue, and become indistinguishable from normal, living bone.

Working at the atomic scale has other advantages. Being able to tweak the ratio of calcium to phosphate alters not only the strength of the NanOss, but also the rate at which it is absorbed and the ease with which it combines with collagen, a protein that is the other main ingredient of bone. Angstrom Medica hopes to use this to customise NanOss to produce implants suitable for patients of different ages: compared to the elderly, young people require implants that can be absorbed rapidly.

The researchers are now seeking other applications for the process. Building from the atoms up clearly makes a difference. In theory, a wide range of improved materials could be made in nanocrystalline form: more proof that small is beautiful.

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Bose-Einstein condensates

Cold, quickly

Jul 5th 2001
From The Economist print edition

A new way has been devised to make a peculiar form of matter

ALBERT EINSTEIN is most famous for the theory of relativity. But even if he had never thought of it, he would still have been a notable physicist. One of his other ideas, developed in the 1920s in collaboration with Satyendra Nath Bose, concerned what would happen to a collection of atoms cooled to within a few billionths of a degree of absolute zero. Bose and Einstein predicted that, in certain circumstances, the atoms would lose their identities and become a single, coherent whole.

Neither man lived to see the idea tested—but it turned out to be right. The first Bose-Einstein condensate (BEC), as this new state of matter is called, was created in 1995. But making it was hard—which is a pity, because if such condensates could be turned out routinely, they might be very useful. Now, a paper published in *Physical Review Letters* by Michael Chapman and his colleagues at the Georgia Institute of Technology in Atlanta outlines a step towards such a routine.

Until now, BECs have been made in a two-stage process. The first stage (at least, after the atoms have been cooled close to absolute zero by more traditional methods) involves an optical “trap”—a set of lasers emitting frequencies of light that slow the atoms down. This lowers their temperature to a still-torrid (for a BEC, anyway) few millionths of a degree above absolute zero. In the second stage, the cooled atoms are transferred to a magnetic trap. There, held steady by powerful magnets, they are cooled by evaporation. The problem with this is that such evaporative cooling takes time—sometimes as long as several minutes. That makes the whole process vulnerable to random sources of heat, or glitches in the magnetic field.

Dr Chapman and his group have managed to eliminate the fragile second stage by creating a BEC in a purely optical trap. They did so not by some great technical breakthrough, but by rigorous attention to detail. For example, they avoided laser frequencies that might induce “spontaneous emissions” of light by the atoms being cooled. Such emissions are a harmful source of heat. And, by reducing the power of their lasers while the condensate was forming, they allowed rapid evaporative cooling. The result was that their atoms (rubidium, in this case) became a BEC in a mere two seconds.

The reason Bose-Einstein condensates may prove useful outside the laboratory is that they are to matter what a laser is to light: all their constituent particles march in step. When you want to do something tricky with light, you often use a laser. It would be nice to be able to do the same thing with a beam of atoms.

Ordinary, not-marching-in-step atomic beams are already used in precision clocks, and to etch some high-performance computer chips. But chip makers are having trouble making more precise beams, and the Global Positioning System, which allows people to locate themselves to within a few metres on the surface of the earth, is limited by the performance of its atomic clocks. In both of these examples, a coherent, BEC-based atomic beam would improve precision massively.

That would be good. It would also, in all likelihood, be just the start. Some people dream of reproducing another trick of lasers—holography. In this case, though, the holograms would not be photographs, but the real, solid thing. Perhaps the most important applications of BECs are as unimaginable at the moment as the supermarket bar-code scanner would have been to the inventor of the laser.

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About sponsorship

Baseball stories

The In and Out club

Jul 5th 2001
From The Economist print edition

Great writing about baseball, or cricket, is about stories, not sport

BASEBALL writers are often given to philosophical excess. With the game's slow rhythms creating a natural tension, most baseball writing tries to capture the action inside the players' heads as much as the action on the field. Poorly done, it is tedious and overblown. But when the writing is right—as it is when Roger Angell holds the pen—it is a real pleasure to read.

In "A Pitcher's Story", the *New Yorker*'s baseball writer follows David Cone (above), a Yankee pitcher, through the 2000 season, a sorry affair during which the once-glittering veteran watched his formidable skills vanish before his eyes. The collapse initially gave Mr Angell the shakes. "Instead of an inside look at a wizardly old master at his late last best", he writes, "this was going to be Merlin falling headlong down the palace stairs, the pointy hat airborne and his wand clattering." Mr Angell casts the story as a tragic drama about an ageing competitor and the emotional strain of coming to terms with lost greatness.

The book rambles at times, and the game's jargon, nicknames and famous moments are seldom explained, which is likely to baffle the uninitiated. Yet Mr Angell's passion for the sport's minutiae is a delight, as are his descriptions of its more colourful players ("Sojo, a Venezuelan, is 34, but looks as if he had put on a much older guy's body that morning by mistake"). Most importantly, Mr Angell proves that a book about defeat can be infinitely more interesting than yet another volume on athletic triumph.

Another kind of triumph is chronicled in "The Duke of Havana": that of political freedom (and the almighty dollar) over an oppressive and archaic regime. The authors tell the story of Orlando "El Duque" Hernandez, a great Cuban pitcher who defected to America on December 25th 1997: the very day that Fidel Castro legalised Christmas in Cuba. El Duque eventually won three world championships with the Yankees. But this is no simple rags to riches tale; it is a study in Cuban culture told through the prism of one of Castro's most prized commodities: his baseball players.

Messrs Fainaru and Sanchez debunk the myth that legions of Cuban players have always dreamed of playing American baseball, lacking only an opportunity to defect. Instead, they focus on the pride that many on the Cuban national team felt as heroes of the state and on why so many bought into the propaganda about the evils of capitalist imperialism. The book is especially strong on the Orwellian nature of the Cuban state.

Too often, however, the authors feel compelled to report every bit of information they have ferreted out. Minute-by-minute accounts of the plots by American sports agents to induce defections become tiresome. Still, they are worth slogging through, as the rest of the book makes for compelling reading.

Neil Sullivan's "A Diamond in the Bronx" is both narrative history and policy briefing, and falls just short of succeeding at either. Most of the book uses the history of Yankee Stadium to tell the political story of New York in the 20th century. Since its construction, the stadium has been a political pawn in the games played by such colossal egos as the Tammany Hall bosses, Mayors John Lindsay and Rudy Giuliani, and George

A Pitcher's Story: Innings with David Cone
By Roger Angell

Warner Books; 256 pages; $24.95

Buy it at
Amazon.com
Amazon.co.uk

The Duke of Havana: Baseball, Cuba, and the Search for the American Dream
By Steve Fainaru and Ray Sanchez

Villard; 376 pages; $24.95

Buy it at
Amazon.com
Amazon.co.uk

The Diamond in the Bronx: Yankee Stadium and the Politics of New York
By Neil J. Sullivan

Oxford University Press; 225 pages; $30 and £30

Buy it at
Amazon.com
Amazon.co.uk

Steinbrenner, who owns the Yankees.

Unfortunately, the book turns into something of a treatise against public funding for sports stadiums. Some of this debate is worthwhile, notably Mr Sullivan's point that both the right and left support public financing for vastly different reasons: the right out of regard for government policies that facilitate enterprise, the left following a sports version of New-Deal economics which implies that new stadium construction will automatically produce jobs and contracts. The author argues that both are wrong, yet his discussion seems, in baseball-speak, to come from left field. As Mr Sullivan should know, the best baseball writing is about philosophy, not policy.

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Cricket

Derring do

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From The Economist print edition

ENGLAND'S cricket team had won four Test match series in a row until drawing the one with Pakistan last month. But this unusual run of success has not reduced the foreboding with which England approach this summer's Ashes series against Australia. The first Test began on July 5th at Edgbaston, in Birmingham. The Australian team is so skilled, so experienced and so fiercely determined that England's followers might soon be forced to seek consolation in Rob Steen's and Alastair McLellan's gripping account of the Test match that lies most indelibly in the memory of England cricket fans.

500-1: The Miracle of Headingley '81
By Rob Steen and Alastair McLellan

BBC Worldwide; 267 pages; £16.99

Buy it at Amazon.co.uk

The match took place at Headingley, in Leeds, in July 1981, and its 20th anniversary promises an orgy of nostalgia. This book will be the most substantial specimen.

The leading roles are played by England's most heroic cricketer, Ian Botham, who had failed miserably as the captain of the team, and by his predecessor, Mike Brearley, who was asked to interrupt his training as a psychoanalyst to take over the role of captain once more. (Mr Brearley has contributed a thoughtful foreword to the book, about styles of leadership and the significance of chance. He also draws a comparison between the 1981 series and Tolstoy's "War and Peace".) The other leading player was the English team's fastest bowler, Bob Willis, whose fitness then was seriously in doubt.

Initially the game went so badly for England that on the third day of the match bookmakers quoted odds against England of 500-1. One of the best chapters in the book blows away the smokescreen put up to obscure the fact that two members of the Australian team—Dennis Lillee and Rodney Marsh—took the bet against their own side and, for an outlay of just £15 ($30) between them, won £7,500. But these odds were made a mockery of by Mr Botham, who scored 149 not out in England's second innings, and by Mr Willis, who took eight wickets for 43 runs in Australia's second. Mr Brearley had led England to victory by 18 runs and the three men became legends in their own lifetime.

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About sponsorship

Contemporary African history

Blood and guts

Jul 5th 2001
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Africa has much to teach the world about forgiveness

IN APRIL 1994, just before South Africans celebrated the end of apartheid by voting in their first democratic election, horror was erupting in another part of Africa: in Rwanda some 800,000 people were systematically murdered in two months.

Both countries then faced a terrible dilemma: what to do about the past? Peace seemed to conflict with justice; the one saying delete the past, the other act on it. South Africa attempted to find a middle way, a dynamic process that neither tried to wipe away the past nor prosecute the guilty. It sought truth and then reconciliation. Politically it established a government of national unity.

The Tutsi-dominated government in Rwanda, which overthrew its genocidal Hutu predecessor, chased the perpetrators into Congo and killed them, and locked up 120,000 suspects at home. It is now experimenting with a traditional local justice system to try them. Rwanda voted against an international tribunal when its mandate did not include the death penalty. Its political policy is to pretend that there is no difference between Hutus and Tutsis and prove that they can, with strict government, live together in peace. In practice strict government means a Tutsi government that tolerates “good” Hutus.

Mahmood Mamdani, an African academic who has worked in South Africa since 1966, says the problem in white-run South Africa was that apartheid had few perpetrators but many beneficiaries; in Rwanda there are few beneficiaries but almost all Hutus took part in genocide. Simple justice, which would perpetuate the bitterness and divisions, would be revenge masquerading as justice. “The price of justice would be the perpetuation of civil war,” he says. He suggests the victors should blame the system, not individuals, making the perpetrators victims too.

Mr Mamdani’s political settlement is not democracy, which would simply restore the majority Hutus to power, but an acceptance of the Hutu and Tutsi with political, not cultural or class affiliations. He recommends a broad-based constitutional settlement that includes everyone prepared to give up violence whatever their ideology. More Burke than Hobbes, this solution is based on the knowledge that the question “who is to be master?” will be answered by death, unless both sides are prepared to cede power

When Victims Become Killers: Colonialism, Nativism, and the Genocide in Rwanda
By Mahmood Mamdani

Princeton University Press; 382 pages; $29.95. James Currey Publishers; £19.95

Buy it at
Amazon.com
Amazon.co.uk

A Country Unmasked: Inside South Africa’s Truth and Reconciliation Commission
By Alex Boraine

Oxford University Press; 466 pages; $30 and £20

Buy it at
Amazon.com
Amazon.co.uk

and answer instead: everyone.

In its transitional government of national unity after the 1994 election, South Africa followed just that solution. Whatever problems the country has now, the revenge that many predicted has not happened.

The Truth and Reconciliation Commission played a vital role in this. It has produced three remarkable books: its own horrific and moving five-volume report; Archbishop Desmond Tutu's "No Future Without Forgiveness" (Doubleday; Rider; 1999); and Antjie Krog's "Country of My Skull" (Times Books; Jonathan Cape; 1999). Archbishop Tutu's is a passionate personal account that mixes the story of the commission with his reflections on the meaning of justice and forgiveness. Ms Krog's, an *Economist* book of the year in 1999, mixes cigarette stubs with the trauma of listening daily to the dreary pornography of planned cruelty.

What is lacking is an insider's account of how the 25 commissioners, together with the victims and the beneficiaries of apartheid all related to each other as they listened to the testimonies, lies and evasions. Alex Boraine, deputy chairman of the Truth and Reconciliation Commission, could have written that, but has not. His book is a clichéd account of what he did and who he liked and disliked, with little flavour of the back rooms and corridors. Lacking both grandeur and gossip, it is, inevitably, a disappointment.

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How to be Number One

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Four new books debate whether America needs a long-term global foreign policy at all

BOOKS IN BRIEF

AMERICA'S most famous foreign-policy mandarin is back again, this time with advice for the Bush administration. Little here is new: warmed-over realism peppered with vigorous criticism of the Clinton legacy, with chapters on international justice and globalisation. Mr Kissinger tackles an array of issues—including China, "rogue states" and the Balkans—but his critiques are similar. He attacks Clinton's foreign policy for having had too much sloppy moralism and too little long-term vision and discipline. Yet many solutions he calls for do not differ dramatically from the policies currently under review.

Does America Need a Foreign Policy? Toward a Diplomacy for the 21st Century
By Henry Kissinger

Simon & Schuster; 318 pages; $30 and £20

Buy it at
Amazon.com
Amazon.co.uk

More intriguing is his excoriation of the movement toward global jurisprudence and an international criminal court. Here Mr Kissinger's liberal critics will charge that his straw men are exaggerated. But they might also admit that his pragmatic outlook provides some relief from the muscular unilateralism in vogue today, at least on a rhetorical level, in certain parts of the administration and in Congress.

SUCH muscular unilateralism is well represented in this collection of writings, published shortly before last year's presidential election. Many of its contributors have close ties to the Bush team, and one, Paul Wolfowitz, is now second-in-command at the Pentagon.

Present Dangers: Crisis and Opportunity in American Foreign and Defence Policy
Edited by Robert Kagan and William Kristol

Encounter Books; 402 pages; $22.95 ($15.95 paperback)

Buy it at
Amazon.com
Amazon.co.uk

The tone of the essays ranges from centre-right to hardline. One author advocates high tariffs against Chinese exports and an unambiguous American commitment to defend Taiwan if China attacks. Another calls for an increase in defence spending by a third so that America can simultaneously engage in the Balkans, fight Iraq and North Korea, and "contemplate war with China or Russia". But this book will probably fail to convince those readers who ask why a nation that houses an unmatched nuclear arsenal and spends more on defence than the next eight countries combined should be so fretful about a perceived strategic "crisis".

EFFECTIVE missile defence may take many years to achieve, but it already dominates American foreign-policy discussions. This lucid and dispassionate book tries to bring the missile debate back to earth and find a middle ground between true believers and sceptics. The authors propose a limited, two-tier defence system that focuses mainly on intercepting missiles from smaller "rogue" states (such as Iraq, Iran and North Korea) in the initial ("boost") phase of their launch.

Defending America: The Case for Limited National Missile Defence
By James M. Lindsay and Michael E. O'Hanlon

Brookings Institution; 258 pages; $24.95. Plymbridge; £18.50

Buy it at
Amazon.com
Amazon.co.uk

A more ambitious version, they say, would destroy the 1972 Anti-Ballistic Missile treaty, compelling Russia to forgo anti-proliferation efforts, avoid deep cuts in offensive nuclear arms and sell countermeasure technologies to the highest bidder. By tying missile defence to broader strategic and foreign-policy issues, Messrs Lindsay and O'Hanlon usefully sort out this complex topic for non-specialists.

READERS seeking an overview of American foreign policy will find this slim volume helpful, although some authors simply rehash the Clinton years.

The more interesting contributions include a piece on promoting democracy and a proposal for bolstering globalisation's legitimacy. A particularly pithy concluding article by Walter McDougall argues that America does not actually need a long-term strategic vision in the absence of a major war or crisis.

The nation should instead build on its core "assets". These include a strong economy and military, regional alliances and the pan-American institutions affecting such challenges as illegal immigration and drugs. Otherwise, he writes, America risks adopting a "grasshopper mode—peripatetic, noisy, hopping into other people's backyards, and unready when the weather turns nasty."

Foreign Policy for America in the Twenty-First Century: Alternative Perspectives
Edited by Thomas H. Henriksen

Hoover Institution Press; 152 pages; $15

Buy it at
Amazon.com

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About sponsorship

Corning glass

Patient money

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SOME companies prosper by making continuous improvements to their business practices. Others grow by using their market clout to acquire rivals for the skills and markets they covet. A few thrive by making patient investments in far-sighted ideas of their own that can take decades to pay off. Rarely does any company attempt to do all three things at once.

Corning, a glass maker that was founded 150 years ago, is one of those rare manufacturing enterprises that has managed to cling to its innovative roots. Apart from the upheaval of the 1970s and 1980s, which affected many American companies that had grown fat in the decades after the second world war, Corning has been remarkably consistent in giving full rein to the ingenuity of its researchers while pursuing total mastery over its process technologies.

Corning and the Craft of Innovation
By Margaret B.W. Graham and Alec T. Shuldiner

Oxford University Press; 512 pages; $29.95 and £21.99

Buy it at
Amazon.com
Amazon.co.uk
Amazon.com
Amazon.co.uk

Its reputation for continuous innovation over a century and a half is unrivalled anywhere. Without Corning's ribbon machine, electric light bulbs, vacuum flasks and cathode ray tubes would have been far costlier and more fragile affairs. Without its patented borosilicate glasses, there would have been no Pyrex ovenware. The glass ceramics called Pyroceram, which the company developed originally for missile nose cones, has not quite made Corning a household name. By contrast, its Corelle line became one of the world's most popular brands of tableware.

The firm's successful casting of the 200-inch (five-metre) mirror for the Hale telescope on Mount Palomar in 1934, a feat that even the mighty General Electric had attempted but failed to achieve, reinforced the company's reputation in the scientific world. Its patented vacuum-deposition processes, secretly used for years in the optics aboard American spy satellites, have made Corning the mirror maker of choice for optical astronomers everywhere since the end of the cold war. Corning's invention of ceramic substrates for catalytic converters made the firm the darling of Detroit. And then there was the optical waveguide—the invention, better known as optical fibre, that has transformed telecommunications the world over.

Fittingly, this book is more than a typical corporate biography. There is little in the way of outright flattery, though the authors are clearly enamoured of their corporate subject. Their concern throughout is to identify the essential ingredients that have made Corning so innovative for so long.

"Patient money" was the principle that guided the Houghton family when it first invested in a small glass company in Somerville, Massachusetts, in 1851. (The firm moved to the city of Corning, New York in 1868). And the Houghton dynasty has influenced the company according to that principle ever since. Lacking access to the cheap immigrant labour, raw materials and exploding markets that rival glass makers enjoyed across the Alleghenies in the Ohio valley, to the west, the Houghtons also insisted that their fledgling corporation should focus exclusively on the specialist end of the business and use inventiveness as its principal competitive weapon. Producing me-too products was out of the question, so Corning's only choice was to be endlessly unorthodox—and so, for the most part, it has remained.

Central to Corning's success in turning unorthodoxy into a winning way has been the management's profound understanding of the value of the company's intellectual property, and its willingness to protect that at any cost. This has meant investing in research and development at a rate almost double that of the rest of the industry. It has also meant refusing to blink when bigger companies with deeper pockets infringed Corning's patents and sought to outspend it in the law courts, as when, one by one, wealthy corporations tried to muscle their way into Corning's optical fibre business. Even giants such as ITT in America and Sumitomo in Japan found to their cost that the feisty little glass maker from upstate New York refused to roll over and play dead. Today, Corning has 40% of the market for optical fibre—nearly three times more than its nearest rival. But it took Corning 15 years of patient investment in optical-fibre

technology to make a profit.

Only once has Corning stumbled badly. The 20-odd acquisitions the company made building its MetPath business into the largest medical-testing organisation in the world smacked of impatient money. Yet in the end, this helped the company rediscover its innovative roots. Once again, the Houghtons, still around and still influential, were there to help nudge Corning back to its 150-year-old formula for patient innovation.

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About sponsorship

Dale Chihuly's glass art

A fragile rainbow

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Richly coloured and extravagantly formed in swirls of red, green, yellow and blue, Dale Chihuly's glass draws on Venice and the Renaissance for inspiration. The American artist's first British exhibition is at the Victoria & Albert Museum until October 21st.

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Summer thrillers

Duet for the sun

Jul 5th 2001
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If you buy no other thrillers this holiday season, buy these two

IN 1999, *The Economist* selected two unusually good first thrillers to include in its books of the year. Two years on, Henry Porter and Mark Burnell have both written second novels that are bigger and richer in every way than their first efforts.

Both feature heroes who have become outlaws but are reeled back into the establishment fold to do one last job. Both are quests dressed up as a moral crusade into the modern hinterland of evil: Mr Burnell chooses Russia, and Mr Porter the killing fields of Bosnia. But whereas Mr Porter's hero is a middle-aged ex-spy whose past is ripped open when a son he never knew he had pays him a visit, Mr Burnell's is a young woman with sharp elbows and so many identities she can hardly remember how the past became the present.

A Spy's Life
By Henry Porter

Orion; 402 pages; £12.99

Buy it at
Amazon.co.uk

Chameleon
By Mark Burnell

HarperCollins; 352 pages; £9.99

Buy it at
Amazon.co.uk

Petra Rauter started out in Mr Burnell's first book, "The Rhythm Section" (HarperCollins, 1999), as Stephanie Patrick, a lippy Yorkshire lass who runs away to London after her parents are killed. She drifts into prostitution and ends up murdering her pimp. Instead of doing time, she is recruited by Magenta House, a freelance offshoot of the intelligence services that makes MI6 look like M&S. She quickly grows to hate her new masters. But having joined them, she decides to beat them. When "Chameleon" opens, she is living in Provence having made off with a great deal of money the Magenta House officials believe is rightfully theirs. Not surprisingly, they come after her.

Mr Porter's hero, Robert Cope Harland, was once tortured and beaten by Czech security agents. Having retired as a spy, he is now working for the UN. In the book's magnificent opening pages, his UN plane has crashed at La Guardia. Harland is thrown from the wreckage into the East River mudflats and is the only survivor. His investigation into the crash leads him back into his old profession. Mr Porter's particular gift is his ability to make technology interesting; Mr Burnell's is an imagination that makes anything seem possible. Both succeed, though, because they have learned the oldest lesson: that characterisation and narrative are all.

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About sponsorship

Fake vintage photographs

Prontoprints

Jul 5th 2001
From The Economist print edition

As vintage photographs rise in price, fakes are becoming more common

PHOTOGRAPHY should be the perfect democracy. From a single negative hundreds of prints can be made, all identical if need be, and, in theory, of equal value. But in the refined world of vintage photography, a Man Ray image, say, soars at least ten-fold if the master printed the negative himself. In 1999 a collector paid $1m for the first time for a photograph, a 1932 print Ray made of his “Glass Tears”. As speculative fever takes hold, more collectors want to cash in on the sharp end of the $200m-a-year fine-art photography market. The problem is how to distinguish between different photographic processes. Indeed, the Association of International Photography Art Dealers (AIPAD) is hosting a three-day seminar in New York from July 8th on collecting vintage photographs and recognising forgeries.

AIPAD was spurred on in part after six top-notch New York photo dealers and an 81-year-old photographer and scholar from Queens, Walter Rosenblum, signed an out-of-court settlement earlier this year that would help refund collectors who had bought “signed vintage” photographs by Lewis Hine that proved to be fake. The deal is widely believed to be the biggest settlement over fake vintage photography.

Hine’s most famous images were of the “spidermen”, the aerial construction workers, who built the Empire State Building. Though Hine was never a dominating figure like Walker Evans or Edward Steichen, collectors now snap up his vintage prints for up to $60,000 each. A copy of “Powerhouse Mechanic” sold at Christie’s in 1994 for $90,000. Despite an improbable number of signed “original” Hine prints on the market, few questions were asked because they came from an impeccable source: Hine’s erstwhile protégé and curator, Mr Rosenblum.

Hine had met Mr Rosenblum in the late 1930s. He became Hine’s conservator after his death in 1940. In 1955 Mr Rosenblum gave nearly 4,000 negatives and 6,000 prints to America’s first photographic museum, the George Eastman House in Rochester. A respected photographer in his own right, Mr Rosenblum’s vintage images fetch about $4,000, while his wife, Naomi, is the author of several well-known books on American photography.

Mr Rosenblum’s vintage Hine photographs were cooler, almost greyish in tone compared with the warm brown tints of Hine’s other vintage work. But the protégé offered a plausible explanation: Hine printed the photographs on special paper for his one-man show at the Riverside Museum in 1939. One print, “Three Riveters”, that came up for sale at Sotheby’s in 1999, was accompanied by a letter from Mr Rosenblum certifying its authenticity.

It was a 40-year-old American theoretical physicist, Michael Mattis, who discovered the truth. Having heard rumours, Mr Mattis asked Paul Messier, a prominent photographic conservator from Boston, to test the authenticity of a couple of his own vintage Hines. “It is easier to date a 15th-century Flemish painting than to find out if a photograph was printed in 1930 or 1960,” says Mr Mattis.

Aided by Walter Rantanen, an FBI forensic expert who specialises in paper analysis, Mr Messier examined minute paper fibres taken from the photographs under a microscope, testing them with chemical stains. Both Mr Mattis and Mr Messier will be speaking at the AIPAD symposium. Mr Messier found that the photographic paper was made of wood pulp not rags, a sure sign that it was made after the 1930s. From the 1950s, optical brightening agents (OBAs) were used to make paper appear whiter. Paper with even tiny amounts of OBAs will glow under ultraviolet light. Finally, a small change in the logo Agfa used as a watermark provided final proof that the photographs were in fact posthumous prints made between 1958 and 1975.

The New York dealers, which include the Howard Greenberg, the Edwyn Houk and the Robert Mann galleries, sold the prints in good faith but will not discuss the out-of-court settlement. Meanwhile, dealers stress that the Hine scandal is an isolated case. Nevertheless, more people will now pay $100,000 for a print. They would be wise to ask for sophisticated scientific proof—as well as the usual stamps, signature and detailed provenance—before they put their hands in their pockets.

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About sponsorship

Queen Modjadji

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From The Economist print edition

Mokope Modjadji V, known as the rain queen, died on June 28th, aged 64

AP

POLITICIANS liked to visit the Northern Province of South Africa, one of the poorest parts of the country. It enabled them to blame their predecessors for the poverty there, and to receive applause for promising a better future. The province was also the home of the Bolebedu, a small tribe but with a rather impressive leader, Queen Modjadji V, the only female tribal leader in southern Africa, and perhaps the only one in the world with a reputation as a rainmaker.

In 1994, when F.W. de Klerk, South Africa's last white president, was dismantling apartheid, he had a chat with Queen Modjadji and said she was "deeply committed to peace". Nelson Mandela visited her several times. The queen had not much cared for his movement, the African National Congress. When its representatives had turned up with its message of "a better life for all" they had received a whipping for not being respectful to traditional ways. Mr Mandela assured her that his government did not want to erode her authority as tribal leader. The queen pressed her advantage by asking for a road to the cave where she liked to practise her rainmaking rites. He said he would do what he could, and meanwhile made her a present of a car. Mr Mandela told reporters that his relations with the rain queen were "close". He asked them not to question her. Like Queen Elizabeth, he said, "she does not answer questions".

All this made readable stories, and Queen Modjadji became quite famous in South Africa. It turned out that she was not as reluctant to talk as Mr Mandela had said, although she asked for a small fee before granting an interview. In these sceptical days, she explained, there was less demand for her rainmaking skills, so times were hard. But did she really claim to produce rain to order? Of course, she told a disbelieving interviewer on television. Her appearance was followed by a downpour, an event all the more impressive because it had been preceded by a long spell of dry weather.

First take a royal lotion

Everyone said it was coincidence. Well, almost everyone. There is a mysticism about rain. Even in the unsentimental world of business, a rainmaker is someone who makes things work. The South African Weather Bureau took an interest in Queen Modjadji's claims. It did seem she was good at predicting weather, a talent not all that rare among rural people, and perhaps more reliable in a country such as South Africa where weather is more strictly seasonal than, say, Britain's. However, in the ceremony to make rain, a key ingredient apparently was a lotion obtained from the bodies of previous queens, something beyond the resources of the weather bureau.

The Bolebedu homeland does get a more reliable supply of rain than the surrounding area. This, say no-nonsense geographers, is because it is situated in a high valley in the Drakensberg mountains that enjoys a more favourable climate. Whatever the reason, the favoured area was never attacked by warriors of the Zulu and Swazi nations that once dominated much of southern Africa. Rather, they sent gifts to the Modjadji queen, requesting that she bring rain to their own domains at times of drought. She was thought to be an oracle and to will the death of anyone who displeased her. The queens were matriarchs. They mated but did not marry. Daughters were valued, and in the old days sons were killed off.

Queen Modjadji's great grandmother, Modjadji II, was believed to be the model for the queen in "She", a novel by Rider Haggard. He made her a white woman, presumably to satisfy Victorian sensibilities, but

otherwise “She who must be obeyed” was up to her deadly African tricks, casting her spell over men in the Modjadji manner. Holly the Englishman describes his first encounter.

> At length the curtain began to move. Who could be behind it? Some naked savage queen, a languishing oriental beauty?...She held the curtain aside with her ivory hand to let me pass in. I entered, shuddering...The place was softly lit...and the air and curtains were laden with subtle perfume. Perfume seemed to emanate from the glorious hair and white-clinging vestments of She herself. “Sit,” said She, pointing to the couch. “As yet thou hast no cause to fear me. If thou hast cause, thou shalt not fear for long, for I shall slay thee. Therefore let thy heart be light.”

She had lived seemingly forever, although Holly assured readers that she was a good-looker. Queen Modjadji did not complain of her more modest lifespan: as a practitioner of reincarnation she assumed that she and her magical powers would pass into another person. This was to have been her daughter, Princess Makhaele, but she died suddenly a few days before her mother. Her subjects will now have to decide who is to be the new queen of the Bolebedu.

At the funeral of the mother and daughter this week the premier of the Northern Province spoke of the queen’s 20-year reign during which numerous schools had been built in her territory. Then, turning to less earthly matters, he noted that there had been a recent eclipse of the sun, plunging parts of southern Africa into darkness. “I think,” he said, “the African heaven chose to mourn her demise in this spectacular way.”

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Output, demand and jobs

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From The Economist print edition

% change at annual rate

	GDP		The Economist poll GDP forecasts		Industrial production	Retail sales (volume)	Unemployment % rate	
	1 qtr	1 year	2001	2002	1 year	1 year	latest	year ago
Australia	+ 4.3	+ 2.1 Q1	+ 2.3	+ 3.8	+ 3.1 Q4*	+ 3.0 Q1	6.9 May	6.5
Austria	+ 1.7	+ 2.6 Q4	+ 2.0	+ 2.3	+ 2.5 Apr	+ 2.6 Mar	3.7 May	3.7
Belgium	+ 1.8	+ 2.4 Q1	+ 2.3	+ 2.6	− 4.1 Apr*	− 1.7 Apr	9.9 Jun*	10.1
Britain	+ 1.7	+ 2.7 Q1	+ 2.2	+ 2.8	− 0.8 Apr	+ 6.4 May	5.0 Apr‡	5.7
Canada	+ 2.5	+ 2.6 Q1†	+ 2.3	+ 3.1	+ 1.0 Apr	+ 3.0 Mar	7.0 May	6.6
Denmark	− 4.6	+ 1.0 Q1	+ 1.5	+ 2.1	+ 1.7 Apr	+ 0.2 Apr	5.2 May	5.4
France	+ 2.0	+ 2.7 Q1	+ 2.2	+ 2.5	+ 1.9 Apr	− 0.3 Apr	8.7 May	9.6
Germany	+ 1.5	+ 1.6 Q1	+ 1.3	+ 2.1	− 0.4 Apr	− 0.7 Apr	9.3 Jun	9.6
Italy	+ 2.8	+ 2.4 Q1	+ 2.0	+ 2.3	+ 2.6 Apr	− 0.8 Apr	9.6 Apr	10.7
Japan	− 0.8	− 0.1 Q1	− 0.3	+ 0.9	− 3.9 May	+ 0.1 Apr	4.9 May	4.6
Netherlands	+ 0.2	+ 2.0 Q1	+ 2.2	+ 2.9	+ 0.2 Apr	− 3.1 Feb	1.9 May§	2.8
Spain	+ 4.1	+ 3.3 Q1	+ 2.7	+ 2.9	+ 0.2 Apr	na	12.9 May	14.3
Sweden	+ 2.4	+ 2.3 Q1	+ 2.3	+ 2.8	− 1.4 Apr	+ 2.3 Apr	3.5 May*	4.1
Switzerland	+ 7.4	+ 2.5 Q1	+ 1.8	+ 2.1	+ 5.1 Q1*	+ 2.2 Mar	1.7 May*	1.9
United States	+ 1.2	+ 2.5 Q1	+ 1.6	+ 2.9	− 2.8 May	+ 2.5 Apr	4.4 May	4.1
Euro area	+ 2.0	+ 2.5 Q1	+ 1.9	+ 2.4	+ 1.6 Apr	+ 1.5 Apr	8.3 May	8.9
MORE COUNTRIES	Data for the countries below are not provided in printed editions of *The Economist*							
Finland	− 0.4	+ 3.4 Q1	na	na	− 2.3 May	+ 6.9 Mar	11.3 May*	11.9
Greece	na	+ 2.5 2000	na	na	+ 8.5 Feb*	+ 5.1 Mar	na	na
Iceland	na	+ 3.6 2000	na	na	+ 2.5 2000	na	1.5 Apr	1.5
Ireland	na	+11.0 Q3	na	na	+17.0 Apr*	+ 1.6 Mar	3.7 May	4.2
Luxembourg	na	+ 8.5 2000	na	na	+ 8.6 Mar*†	+ 6.7 Mar	2.4 May	2.7
New Zealand	+ 0.9	+ 0.4 Q1	na	na	+ 0.9 Q4*	+ 1.7 Q1	5.4 Q1	6.4
Norway	+ 0.9	+ 0.3 Q1	na	na	+ 1.1 Apr	− 1.0 Apr	3.7 Q1	3.9
Portugal	+ 2.2	+ 3.4 Q4	na	na	+ 4.5 Apr*	+ 5.3 Mar	4.2 Q1	4.4

*Not seasonally adjusted. †New series. ‡Feb-Apr; claimant count rate 3.2% in May. §Mar-May

Text refers only to the first 16 countries listed

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Overview

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From The Economist print edition

Japan is almost certainly in recession. Industrial production fell by 3.9% in the year to May; during the past three months it has plunged by 17.2% at an annual rate. As expected, the Bank of Japan's Tankan index of business confidence fell sharply in June. Japan's unemployment rate rose to 4.9% in May, returning to its record high last reached in January. Consumer prices fell by 0.5% in the year to May, while the core rate of inflation (excluding fresh food) fell to minus 0.7%, the largest decline on record.

America's first-quarter GDP growth was revised down slightly to an annualised 1.2%. Manufacturing was stronger than expected in June; the National Association of Purchasing Managers' index of factory activity rose to 44.7 from 42.1 in May. This was the highest figure since November. But a number below 50 indicates that output is still contracting, as it has been since August 2000.

The **euro area** saw a further decline in manufacturing activity in June. The Reuters-NTC purchasing managers' index fell from 48.5 in May to 47.9 in June, its lowest level since December 1998. However, the **French** index actually rose slightly, while the **German** index fell sharply. Unemployment in the euro area was unchanged at 8.3% in May, but **Spain's** jobless rate fell to 12.9%, its lowest level since December 1979. Producer-price inflation in the euro area fell to 3.6% in May.

Unexpectedly good economic news sent **Australia's** ATX stock index to an all-time high.

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Prices and wages

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% change at annual rate

	Consumer prices* 1 year		Consumer prices* year ago	The Economist poll consumer prices forecast 2001	The Economist poll consumer prices forecast 2002	Producer prices* 1 year		Producer prices* year ago	Wages/earnings 1 year		Wages/earnings year ago
Australia	+ 6.0	Q1	+ 2.8	+ 4.0	+ 2.4	+ 5.2	Q1	+ 5.6	+ 5.6	Q1	+ 2.9
Austria	+ 3.4	May	+ 1.8	+ 2.3	+ 1.7	+ 3.1	May	+ 2.7	+ 2.7	May	+ 1.9
Belgium	+ 2.9	Jun	+ 2.8	+ 2.4	+ 1.9	+ 4.7	Apr	+ 7.5	+ 1.9	Q1	+ 3.3
Britain	+ 2.1	May	+ 3.1	+ 2.1	+ 2.4	+ 0.6	May	+ 2.5	+ 5.2	Apr	+ 5.1
Canada	+ 3.9	May	+ 2.4	+ 2.8	+ 2.1	+ 2.7	May	+ 5.9	+ 0.9	Apr	+ 3.1
Denmark	+ 2.7	May	+ 3.3	+ 2.4	+ 2.2	+ 2.9	May	+ 6.4	+ 3.8	Q1	+ 3.6
France	+ 2.3	May	+ 1.5	+ 1.8	+ 1.5	+ 2.8	May	+ 5.8	+ 4.3	Q1	+ 5.2
Germany	+ 3.1	June	+ 1.9	+ 2.7	+ 1.7	+ 4.0	May	+ 4.9	+ 1.4	Apr*	+ 2.3
Italy	+ 3.0	June	+ 2.7	+ 2.7	+ 2.1	+ 2.9	May	+ 6.4	+ 2.7	May*	+ 2.3
Japan	− 0.5	May	− 0.7	− 0.4	− 0.3	+ 0.9	May	− 0.6	nil	May	+ 2.1
Netherlands	+ 4.9	May	+ 2.4	+ 4.6	+ 2.7	+ 5.6	Apr	+ 7.3	+ 3.9	May	+ 3.3
Spain	+ 4.2	May	+ 3.2	+ 3.7	+ 2.8	+ 2.7	May	+ 5.8	+ 2.2	Q4	+ 2.4
Sweden	+ 3.0	May	+ 1.4	+ 2.2	+ 1.8	+ 2.6	May	+ 3.7	+ 1.8	Apr*	+ 4.1
Switzerland	+ 1.6	Jun	+ 1.8	+ 1.3	+ 1.3	+ 0.4	May	+ 3.0	+ 1.3	2000	+ 0.3
United States	+ 3.6	May	+ 3.2	+ 3.2	+ 2.3	+ 3.8	May	+ 3.7	+ 4.3	May	+ 3.6
Euro area	+ 3.4	May	+ 1.9	+ 2.7	+ 1.9	+ 3.6	May	+ 5.3	+ 2.4	Q4	+ 2.3
MORE COUNTRIES	Data for the countries below are not provided in printed editions of *The Economist*										
Finland	+ 3.4	May	+ 2.9	na	na	+ 3.0	May	+ 8.6	+ 5.0	Q1*	+ 3.5
Greece	+ 3.6	May	+ 2.9	na	na	+ 5.1	Apr	+ 7.0	na		na
Iceland	+ 6.8	Jun	+ 5.5	na	na	+ 5.9	Jun	+ 3.9	+ 8.0	May	+ 7.1
Ireland	+ 5.4	May	+ 5.2	na	na	+ 2.4	May	+ 5.9	+ 6.4	Q4*	+ 7.3
Luxembourg	+ 3.3	May	+ 2.5	na	na	+ 2.5	Apr	+ 5.5	+ 7.2	Mar*	+ 4.2
New Zealand	+ 3.1	Q1	+ 1.5	na	na	+ 7.8	Q1	+ 4.9	+ 1.8	Q1	+ 1.4
Norway	+ 4.3	May	+ 2.8	na	na	+ 4.6	May	+ 8.0	+ 4.4	Q1*	+ 4.1
Portugal	+ 4.8	May	+ 2.6	na	na	+ 5.6	May	+14.9	+ 2.4	Apr*	na

*Not seasonally adjusted.

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Economic forecasts

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From The Economist print edition

Every month *The Economist* surveys a group of economic forecasters and calculates the average of their predictions for economic growth, inflation and current-account balances for 15 countries and the euro area. The table also shows the highest and lowest projections for economic growth. The previous month's forecasts, where different, are shown in brackets. The panel now thinks that the Japanese economy will shrink this year and grow by less than 1% in 2002. It has also become gloomier about Europe's prospects, downgrading growth in the euro area in 2001 from 2.2% to 1.9%. Germany is forecast to grow by only 1.3% this year. Adding to the misery, the outlook for inflation in 2001 has deteriorated almost across the board, most notably in the Netherlands. Japan, beset by deflation as well as recession, is the only exception to the rise in expected inflation this year.

	Real GDP, % change				Consumer prices		Current account	
	Low/high range		average		% increase		% of GDP	
	2001	2002	2001	2002	2001	2002	2001	2002
Australia	1.8/3.1	3.2/4.4	2.3 (2.1)	3.8 (3.9)	4.0 (3.6)	2.4 (2.3)	−3.0(−2.4)	−3.0 (−2.5)
Austria	1.4/2.3	2.0/2.6	2.0 (2.1)	2.3 (2.4)	2.3 (1.9)	1.7 (1.4)	−2.2(−2.5)	−2.0 (−2.4)
Belgium	1.9/2.8	2.0/3.0	2.3 (2.5)	2.6	2.4 (2.1)	1.9 (1.8)	4.2 (4.1)	4.5 (4.3)
Britain	1.9/2.5	2.5/3.3	2.2	2.8 (2.7)	2.1 (2.0)	2.4 (2.3)	−2.1(−2.0)	−2.4 (−2.1)
Canada	1.5/3.2	2.0/4.1	2.3 (2.2)	3.1	2.8 (2.4)	2.1	3.3 (1.5)	2.6 (1.1)
Denmark	0.5/2.2	1.7/2.5	1.5 (1.8)	2.1 (2.2)	2.4 (2.3)	2.2	1.6 (1.4)	1.7 (1.5)
France	2.1/2.5	2.2/2.8	2.2 (2.4)	2.5	1.8 (1.5)	1.5	1.7 (1.8)	1.8
Germany	0.8/1.5	1.6/2.5	1.3 (1.6)	2.1 (2.3)	2.7 (2.3)	1.7 (1.5)	−0.8(−1.2)	−0.6 (−0.9)
Italy	1.6/2.3	1.7/2.7	2.0 (2.1)	2.3	2.7 (2.5)	2.1 (1.9)	−0.3	−0.1 nil
Japan	−0.9/1.3	nil/2.7	−0.3 (0.5)	0.9 (1.3)	−0.4	−0.3	2.2	2.0 (2.2)
Netherlands	1.5/2.6	2.3/3.5	2.2 (2.6)	2.9	4.6 (4.0)	2.7 (2.3)	4.1 (3.7)	4.0 (3.8)
Spain	2.3/3.0	2.5/3.5	2.7 (2.8)	2.9 (3.0)	3.7 (3.3)	2.8 (2.6)	−2.8(−2.9)	−2.7 (−2.6)
Sweden	1.8/3.0	2.2/3.4	2.3 (2.4)	2.8 (2.9)	2.2 (1.9)	1.8 (1.7)	2.1 (2.2)	2.3 (2.2)
Switzerland	1.6/2.2	1.6/2.8	1.8 (1.9)	2.1	1.3 (1.2)	1.3 (1.2)	11.5(11.8)	11.5 (11.4)
United States	1.0/2.2	1.0/3.7	1.6	2.9	3.2 (2.9)	2.3 (2.4)	−4.1(−4.2)	−3.9 (−4.0)
Euro area	1.6/2.2	1.8/2.7	1.9 (2.2)	2.4 (2.5)	2.7 (2.3)	1.9 (1.7)	−0.3	−0.1 (−0.2)

Sources: ABN Amro, Deutsche Bank, EIU, Goldman Sachs, HSBC Securities, KBC Bank, Merrill Lynch, J.P. Morgan, Morgan Stanley Dean Witter, Nordbanken, Decision Economics, Royal Bank of Canada, Salomon Smith Barney, Scotiabank, Shinsei Bank, Warburg Dillon Read.

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Money and interest rates

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	Money supply* % change on year ago			Interest rates % p.a. (Jul 4th 2001)					
				3-mth money market		2-year	10-year gov't bonds		corporate
	narrow	broad		latest	year ago	gov't bonds	latest	year ago	bonds
Australia	+13.1	+ 6.9	May	5.05	6.17	5.49	6.20	6.08	7.74
Britain	+ 6.7	+ 7.4	May	5.25	6.06	5.44	5.28	5.12	6.65
Canada	+12.7	+ 6.2	May	4.34	5.57	5.00	5.92	5.80	7.15
Denmark	+ 1.5	- 3.5	Apr	4.85	5.43	4.86	5.33	5.66	7.20
Japan	+ 7.0	+ 2.9	May	0.01	0.12	0.04	1.25	1.73	1.41
Sweden	+ 5.9	- 1.4	May	4.28	4.03	4.90	5.45	5.20	5.75
Switzerland	- 1.2	+ 2.2	May	3.25	3.44	3.10	3.38	3.86	4.15
United States	+ 1.0	+10.9	May	3.69§	6.58	4.23	5.38	6.42	7.06§
Euro area†	+ 3.5	+ 5.4	May	4.45	4.72	4.36	5.05	5.16	5.60

*Narrow: M1 except Britain and Sweden M0, broad: M2 or M3 except Britain M4. † Germany for bonds. § July 3rd. Benchmarks: US 30-year 5.73%, Japan No.232 1.27%. Central bank rates: US fed funds 3.75%, ECB refinancing 4.50%, BOJ overnight call 0.01%, BOE repo 5.25%. Sources: Commerzbank, Danske Bank, J.P. Morgan Chase, Royal Bank of Canada, OM Fixed Income Exchange, Warburg Dillon Read, DRI-WEFA, Westpac, Thomson Financial Datastream. Rates cannot be construed as banks' offers.

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Stockmarkets

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From The Economist print edition

Market indices

	Jul 4th	2001 high	2001 low	% change on one week	% change on record high	Dec 31st 2000 in local currency	Dec 31st 2000 in $ terms
Australia (All Ordinaries)	3,372.2	3,425.2	3,094.3	+ 0.7	- 1.5	+ 6.9	- 0.2
Austria (ATX)	1,206.9	1,244.9	1,052.2	- 1.5	-30.5	+12.4	+ 1.3
Belgium (Bel 20)	2,881.2	3,030.4	2,591.6	+ 1.2	-21.7	- 4.7	-14.2
Britain (FTSE 100)	5,600.5	6,334.5	5,314.8	- 0.1	-19.2	-10.0	-15.3
Canada (Toronto Composite)	7,730.6	9,348.4	7,415.5	+ 2.7	-32.1	-13.5	-14.0
Denmark (KBX)	263.0**	294.3	234.7	+ 0.8	-12.8	- 0.6	-10.2
France (SBF 250)	3,317.0	3,820.2	3,107.9	+ 2.1	-24.5	-12.0	-20.8
(CAC 40)	5,175.1	5,998.5	4,824.8	+ 2.3	-25.2	-12.7	-21.3
Germany (Xetra DAX)	6,015.7	6,795.1	5,388.0	+ 3.1	-25.4	- 6.5	-15.8
Italy (BCI)	1,652.1	1,948.4	1,601.2	+ 2.7	-24.3	-13.8	-22.3
Japan (Nikkei 225)	12,629.0	14,529.4	11,819.7	- 1.6	-67.5	- 8.4	-15.9
(Topix)	1,278.0	1,441.0	1,162.0	- 0.8	-55.7	- 0.4	- 8.6
Netherlands (AEX)	575.7	642.3	518.3	+ 3.1	-17.9	- 9.7	-18.7
Spain (Madrid SE)	865.1	963.9	818.6	+ 1.6	-24.5	- 1.8	-11.5
Sweden (Affarsvarlden Gen)	236.2	292.7	217.2	+ 2.1	-40.9	-14.9	-26.2
Switzerland (Swiss Market)	7,177.9	8,135.4	6,574.0	+ 2.6	-14.7	-11.8	-20.5
United States (DJIA)	10,571.1§	11,337.9	9,389.5	+ 1.3	- 9.8	- 2.0	- 2.0
(S&P 500)	1,234.5§	1,373.7	1,103.3	+ 1.9	-19.2	- 6.5	- 6.5
(Nasdaq Comp)	2,140.8§	2,859.2	1,638.8	+ 3.2	-57.6	-13.3	-13.3
Europe (FTSE Eurotop 300) *	1,387.9	1,545.5	1,279.0	+ 1.8	-18.6	- 9.5	-18.5
Euro area (FTSE Ebloc 100) *	1,235.3	1,404.1	1,143.9	+ 2.2	-20.3	-11.3	-20.1
World (MSCI) †	1,086.9	1,249.2	1,014.6	+ 1.0	-25.1	na	-11.1
World bond market (Salomon) ‡	423.6§	447.8	423.8	- 1.2	- 7.7	na	- 4.4

*In euro terms. † Morgan Stanley Capital International index includes individual markets listed above plus eight others, in dollar terms. ‡ Salomon Smith Barney World Government Bond Index, total return, in dollar terms. **New index. §July 3rd.

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Commodity price index

Jul 5th 2001
From The Economist print edition

1995=100

	Jun 26th	Jul 3rd*	% change on one month	% change on one year
Dollar index				
All items	68.2	68.6	– 2.3	– 4.3
Food	66.6	67.9	+ 0.8	– 2.4
Industrials				
All	70.4	69.6	– 6.0	– 6.8
Nfa†	69.3	68.0	– 7.1	– 0.4
Metals	71.3	70.8	– 5.1	–11.4
Sterling index				
All items	76.0	76.9	– 2.1	+ 3.0
Euro index				
All items	104.1	106.6	– 2.1	+ 7.3
Yen index				
All items	89.9	90.9	+ 1.3	+12.1
Gold				
$ per oz	274.45	268.40	+ 1.0	– 6.4
West Texas Intermediate				
$ per barrel	26.69	26.32	– 5.2	–16.4

* Provisional. † Non-food agriculturals.

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Trade, exchange rates and budgets

Jul 5th 2001
From The Economist print edition

	Trade balance*, $bn latest 12 months		Current account $bn latest 12 mths		The Economist poll % of GDP, forecast 2001	2002	Exchange rate trade-weighted† Jul 4th	year ago	Currency units per $ Jul 4th	year ago	per £	per euro	per ¥100	Budget balance % of GDP 2001‡
Australia	− 1.4	May	− 12.9	Q1	− 3.0	− 3.0	74.1	76.7	1.93	1.69	2.71	1.63	1.55	0.1
Austria	− 5.5	Mar	− 4.5	Apr	− 2.2	− 2.0	99.6	100.3	16.3	14.4	22.9	13.8	13.1	-0.6
Belgium	+ 12.5	Apr	+ 11.6	Dec	+ 4.2	+ 4.5	98.0	99.3	47.7	42.2	67.1	40.3	38.3	0.7
Britain	− 44.2	Apr	− 19.2	Q1	− 2.1	− 2.4	107.9	104.5	0.71	0.66	–	0.60	0.57	1.2
Canada	+ 45.8	Apr	+ 22.2	Q1	+ 3.3	+ 2.6	80.0	79.4	1.51	1.49	2.13	1.28	1.21	2.6
Denmark	+ 6.1	Apr	+ 3.9	Apr	+ 1.6	+ 1.7	101.1	101.2	8.80	7.80	12.4	7.44	7.07	2.9
France	+ 0.5	Apr	+ 21.3	Apr	+ 1.7	+ 1.8	100.5	102.1	7.76	6.86	10.9	6.56	6.23	-0.5
Germany	+ 54.4	Apr	− 21.3	Apr	− 0.8	− 0.6	97.3	98.9	2.31	2.04	3.25	1.96	1.86	-1.7
Italy	+ 2.2	Apr	− 5.9	Mar	− 0.3	− 0.1	71.7	72.8	2,289	2,024	3,220	1,936	1,839	-1.3
Japan	+100.3	Apr	+106.4	Apr	+ 2.2	+ 2.0	138.2	152.8	124	107	175	105	–	-6.3
Netherlands	+ 17.3	Apr	+ 16.0	Q1	+ 4.1	+ 4.0	96.7	98.2	2.61	2.30	3.66	2.20	2.09	1.3
Spain	− 38.9	Apr	− 16.7	Mar	− 2.8	− 2.7	73.5	74.4	197	174	277	166	158	nil
Sweden	+ 12.9	May	+ 5.5	Apr	+ 2.1	+ 2.3	74.8	83.7	10.89	8.80	15.3	9.21	8.75	3.6
Switzerland	− 0.1	May	+ 31.1	Q4	+11.5	+11.5	107.2	106.5	1.80	1.62	2.53	1.52	1.44	na
United States	−458.2	Apr	−449.3	Q1	− 4.1	− 3.9	121.2	109.6	–	–	1.41	0.85	0.80	2.1
Euro area	− 6.8	Apr	− 30.0	Apr	− 0.3	− 0.1	76.2	80.5	1.18	1.05	1.66	–	0.95	-0.6
MORE COUNTRIES	Data for the countries below are not provided in printed editions of *The Economist*													
Finland	+ 13.5	Apr	+ 9.5	Apr	na	na	77.2	77.5	6.91	6.22	9.72	5.84	5.55	5.3
Greece	− 7.5	Jan	− 7.7	Jan	na	na	56.9	58.2	396	352	557	335	318	nil
Iceland	− 0.4	Apr	− 0.9	Q4	na	na	na	na	103	76.7	145	87.1	82.8	2.4
Ireland	+ 27.6	Mar	− 0.7	Q4	na	na	85.5	88.2	0.92	0.82	1.29	0.77	0.74	4.5
Luxembourg	− 2.4	Mar	+ 1.6	Q4	na	na	98.0	99.3	46.9	42.2	66.0	39.7	37.7	3.6
New Zealand	− 0.1	May	− 2.3	Q1	na	na	78.7	80.7	2.41	2.17	3.39	2.04	1.94	1.0
Norway	+ 28.1	May	+ 25.6	Apr	na	na	95.4	92.5	9.19	8.57	12.9	7.77	7.38	15.3
Portugal	− 10.9	Mar	− 9.9	Apr	na	na	88.6	89.5	233	210	328	197	187	-1.2

*Merchandise. Australia, Britain, France, Canada, Japan and United States imports fob, exports fob. All others cif/fob. †1990=100, Bank of England. ‡OECD estimate.

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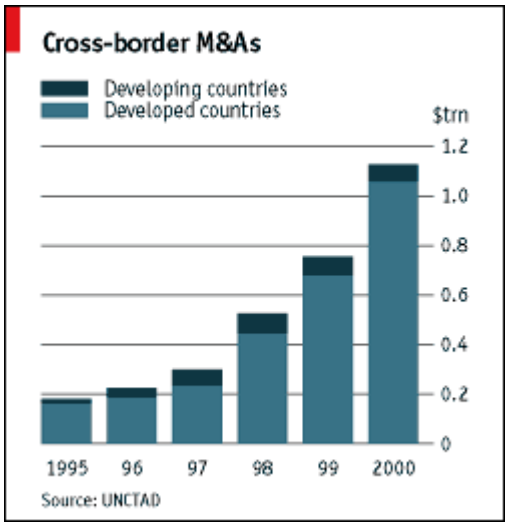
Cross-border M&As

Jul 5th 2001
From The Economist print edition

The value of cross-border mergers and acquisitions (M&A) completed in 2000 rose to $1.1 trillion, nearly 50% higher than in 1999. Cross-border M&A has been a driving force behind the recent growth in foreign direct investment.



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Financial markets

Jul 5th 2001
From The Economist print edition

	Currency units			Interest rates	Stockmarkets	% change on		
	per $		per £	short-term	Jul 4th		Dec 31st 2000	
	Jul 4th	year ago	Jul 4th	% p.a.		one week	in local currency	in $ terms
China	8.28	8.28	11.6	na	2,294.1	-1.1	+4.6	+4.6
Hong Kong	7.80	7.80	11.0	3.69	13,207.5	+1.6	-12.5	-12.5
India	47.1	44.7	66.3	7.08	3,311.9	-2.9	-16.6	-17.4
Indonesia	11,365	9,375	15,984	17.07	429.0	-1.6	+3.0	-12.3
Malaysia	3.80	3.80	5.34	3.30	598.1	+1.3	-12.0	-12.0
Philippines	53.0	43.8	74.5	10.56	1,386.0	-2.1	-7.3	-12.4
Singapore	1.82	1.74	2.57	3.82	1,693.7	-0.6	-12.1	-16.4
South Korea	1,296	1,117	1,822	5.53	597.3	+2.1	+18.4	+15.6
Taiwan	34.4	30.8	48.4	3.90	4,739.2	-1.8	-0.1	-4.0
Thailand	45.5	39.6	64.0	4.00	326.4	+1.0	+21.3	+15.6
Argentina	1.00	1.00	1.41	10.79	386.0	-7.5	-7.4	-7.5
Brazil	2.39	1.80	3.36	18.32	14,056.0	-1.8	-9.9	-26.4
Chile	640	536	899	3.52**	5,404.7	+0.9	+11.0	-0.4
Colombia	2,304	2,169	3,240	12.75	884.0††	+0.1	+24.0	+20.4
Mexico	9.07	9.52	12.7	8.99	6,868.9	+4.3	+21.5	+28.8
Peru	3.52	3.49	4.9	9.76	1,341.8	+0.0	+11.0	+11.3
Venezuela	719	683	1,012	12.90	7,511.2	+2.6	+10.6	+7.5
Egypt	3.93	3.49	5.53	9.06	6,237.2	+5.1	-18.6	-19.4
Israel	4.18	4.08	5.88	4.99	419.5	+3.1	-15.2	-18.0
South Africa	8.08	6.78	11.4	9.90	8,993.6	-2.6	+8.0	+1.2
Turkey	1,276,000	620,215	1,794,566	60.00	11,082.3	-0.7	+17.4	-38.3
Czech Republic	39.9	37.3	56.1	5.10	413.0	-0.9	-13.7	-18.6
Hungary	285	272	400	11.06	6,666.5	+0.6	-15.1	-15.8
Poland	4.00	4.32	5.63	16.09	13,367.1	-4.6	-25.1	-22.6
Russia	29.2	28.0	41.1	25.00	214.4†	-3.4	+52.5	+49.6
EMF (MSCI)‡	1.00	1.00	1.41	na	318.2	-0.1	na	-3.9
EMBI+§	1.00	1.00	1.41	na	212.9*	-0.9	na	+5.4

**Inflation adj. †In $ terms. ††June 29th. ‡Emerging Markets Free. §J.P. Morgan Chase's Emerging Markets Bond Index Plus. *Jul 3rd.

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Overview

Jul 5th 2001
From The Economist print edition

Many East Asian economies are slowing at an alarming pace. The 12-month rate of growth in **South Korea's** industrial production fell to 2.3% in May, down from 20.3% a year ago. The country's exports fell by 13% in the year to June; its 12-month trade surplus narrowed to $14.3 billion. Over the same period, industrial output fell by 10.9% in **Singapore**.Singapore's production of electronic goods plunged by 20% in the year to May.

A drop in telecom stocks and growing fears about an economic slowdown knocked 4.6% off **Poland's** stockmarket over the week. Share prices hit a 27-month low.

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Economy

Jul 5th 2001
From The Economist print edition

	% change on year earlier						Latest 12 months, $bn				Foreign reserves* $bn, latest	
	GDP		Industrial production		Consumer prices		Trade balance		Current account			
China	+ 8.1	Q1	+10.2	May	+ 1.7	May	+21.1	May	+20.5	2000	178.0	Feb
Hong Kong	+ 2.5	Q1	− 0.1	Q1	− 1.5	May	−11.9	Apr	+ 8.8	Q4	114.7	May
India	+ 5.7	Q3	+ 2.7	Apr	+ 2.5	May	− 5.7	Apr	− 5.4	Q4	40.1	May
Indonesia	+ 4.0	Q1	+ 4.5	Q4	+12.1	Jun	+25.7	May	+ 5.5	Q3	22.1	Apr
Malaysia	+ 3.2	Q1	− 0.3	Apr	+ 1.6	May	+15.7	May	+ 8.4	Q4	26.8	Mar
Philippines	+ 2.5	Q1	+12.7	Apr	+ 6.7	Jun	+ 6.7	Apr	+ 9.5	Feb	12.8	Mar
Singapore	+ 4.5	Q1	−10.9	May	+ 1.9	May	+ 4.9	May	+21.8	Q1	77.6	Mar
South Korea	+ 3.7	Q1	+ 2.3	May	+ 5.2	Jun	+14.3	Jun	+14.7	May	93.4	May
Taiwan	+ 1.1	Q1	− 8.2	May	− 0.2	Jun	+11.4	May	+12.0	Q1	110.6	May
Thailand	+ 1.8	Q1	+ 1.6	May	+ 2.3	Jun	+ 2.8	May	+ 6.6	May	31.4	May
Argentina	− 2.1	Q1	+ 0.4	May	+ 0.2	May	+ 1.6	Apr	− 9.0	Q1	20.5	Apr
Brazil	+ 4.1	Q1	+ 6.1	Apr	+ 7.7	May	− 1.6	May	+27.1	May	34.7	Apr
Chile	+ 3.3	Q1	+ 3.2	May	+ 3.7	May	+ 1.5	May	− 1.4	Q1	14.3	Apr
Colombia	+ 1.7	Q1	+ 4.0	Apr	+ 7.9	May	+ 1.6	Apr	− 0.1	Q4	9.7	Apr
Mexico	+ 1.9	Q1	− 3.2	Apr	+ 7.0	May	− 9.7	May	−17.8	Q1	40.3	Apr
Peru	− 0.9	Apr	+ 2.4	Apr	+ 2.6	May	− 0.4	Apr	− 1.7	Q4	8.2	Mar
Venezuela	+ 3.5	Q1	na		+12.5	Jun	+17.2	Dec	+12.5	Q1	11.5	Apr
Egypt	+ 6.5	2000†	+ 9.4	2000†	+ 2.4	Mar	−10.4	Q4	− 0.8	Q4	12.9	Feb
Israel	+ 1.8	Q1	+ 0.3	Apr	+ 0.7	May	− 7.5	May	− 0.7	Q3	22.2	May
South Africa	+ 2.7	Q1	+ 7.3	Apr	+ 6.4	May	+ 3.8	May	+ 0.1	Q1	6.1	Apr
Turkey	− 1.9	Q1	−10.5	Apr	+56.1	Jun	−24.6	Apr	− 6.6	Apr	18.5	Apr
Czech Republic	+ 3.8	Q1	+11.4	Apr	+ 5.0	May	− 3.6	May	− 2.7	Q1	12.6	May
Hungary	+ 4.4	Q1	+ 9.4	Apr	+10.8	May	− 2.4	May	− 1.8	May	11.3	Apr
Poland	+ 2.3	Q1	− 1.0	May	+ 6.9	May	−10.2	May	− 9.0	May	26.9	Apr
Russia	+ 4.9	Q1	+ 5.2	Apr	+25.0	May	+60.5	Apr	+45.9	Q1	25.9	Mar
MORE COUNTRIES	Data for the countries below are not provided in printed editions of *The Economist*											
Pakistan	+ 5.6	2000†	−12.9	Dec	+ 3.9	Apr	− 1.7	May	− 1.4	1999	1.2	Apr
Saudi Arabia	− 0.8	1999	na		− 0.2	Mar	+24.9	1999	+ 0.4	1999	16.9	Mar

*Excluding gold, except Singapore; IMF definition. †Year ending June.

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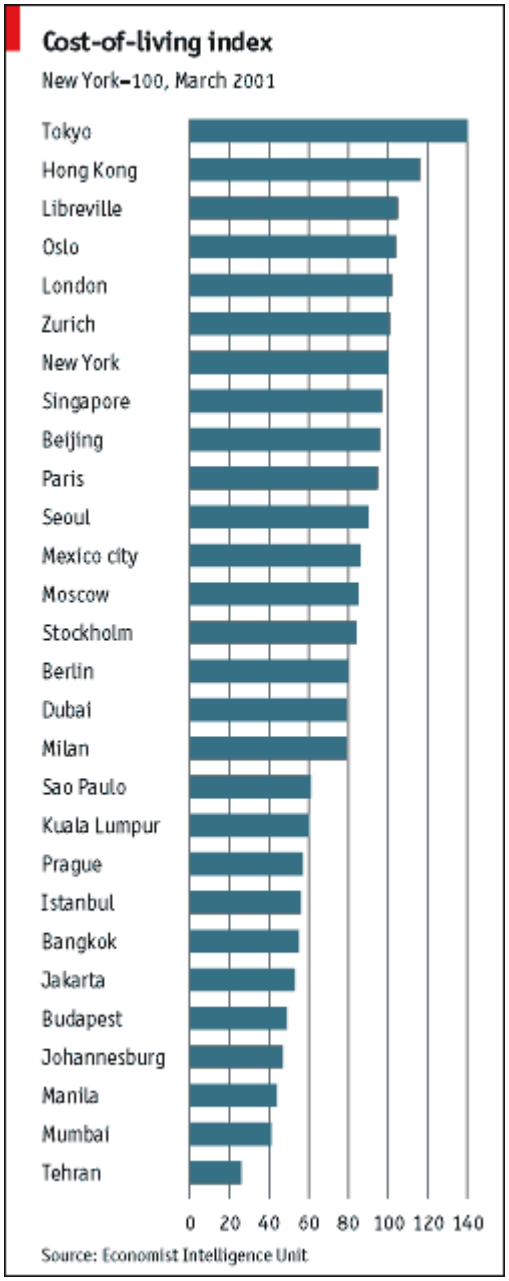
Cost–of–living index

Jul 5th 2001
From The Economist print edition

According to the latest cost-of-living index prepared by the Economist Intelligence Unit, a sister organisation of *The Economist*, the world's costliest city is Tokyo. The index tracks prices in 133 cities compared with New York, which scores 100. Tokyo scores 140. Oslo (at 104) is Europe's most expensive place.



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